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THE McCARRAN-FERGUSON ACT—STATE ANTITRUST ACTION AGAINST INSURANCE AGENCIES

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST,
MONOPOLIES AND BUSINESS RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

ON

S. 1299

A BILL TO AMEND THE McCARRAN-FERGUSON ACT TO LIMIT THE FEDERAL ANTITRUST EXEMPTION OF THE BUSINESS OF INSURANCE, TO REAFFIRM THE CONTINUED STATE REGULATION OF THE BUSINESS OF INSURANCE, AND FOR OTHER PURPOSES

JUNE 14, 1988

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THE McCARRAN-FERGUSON ACT—STATE ANTI-TRUST ACTION AGAINST INSURANCE AGENCIES

TUESDAY, JUNE 14, 1988

U.S. SENATE,
SUBCOMMITTEE ON ANTITRUST, MONOPOLIES,
AND BUSINESS RIGHTS,
COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:37 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Howard M. Metzenbaum (chairman of the subcommittee) presiding.

Also present: Senators Simon, Heflin, and Hatch.

OPENING STATEMENT OF SEN. HOWARD M. METZENBAUM

Senator METZENBAUM. The Subcommittee on Antitrust, Monopolies, and Business Rights will come to order.

Today's hearing continues our consideration of S. 1299, legislation to repeal the insurance antitrust exemption.

We will look at the exemption in light of new State charges that the recent insurance "crisis" was manufactured at least in part by an illegal international boycott among insurers, reinsurers, and the Insurance Services Office, ISO, the industry's rate-setting arm.

Boycotts are not exempt from the Federal antitrust laws, but price-fixing is. In order to bring this case, the States must prove any conspiracy was a boycott. Clearly, though, price-fixing charges also would have been considered were it not for the exemption. The exemption should no longer continue to exist.

As California Attorney General Van De Kamp explained: "The rate recommendation function of ISO, although anti-competitive and illegal in any other industry, is not a part of the cases, because the insurance industry has a special exemption from the antitrust laws that covers this conduct."

The insurance lobby has been able to shield price-fixing from Federal antitrust scrutiny not by force of argument, but by sheer political muscle. There is no need to repeal the exemption, they lamely say, since there is no collusion.

At least nine State attorneys general—and now I understand it will be at least 19 State attorneys general—beg to differ. We will hear today a tale of international collusion and exploitation that, if true, will establish the antitrust conspiracy of the century.

The complaints are only allegations, of course, and will have to be proven in a court of law. And the industry has vigorously denied them and will do so today.

But the Congress cannot take lightly the considered judgment of so many antitrust enforcers that a massive industry conspiracy contributed to the human pain and havoc wreaked in communities all across America by the recent crisis.

If these law enforcement officials can prove their case, the insurance industry will be guilty of behavior that runs counter to the American tradition of a vigorous and open marketplace. Free competition is the underpinning of the free enterprise system. The alleged conspiracy, if proven, not only restrained competition, but it eliminated needed coverage for many communities, exorbitantly escalated rates, and caused communities across the breadth of this Nation to eliminate police services, day care centers, athletic programs, roadbuilding and a host of other essential community services.

My hope, frankly, is that the States' bold attempt to show that these devastating effects were the result of an illegal conspiracy will move Congress to see more clearly the merit of appealing this antiquated special interest exemption.

For as long as it remains on the books, strong antitrust enforcement will be impaired, and consumers will be the losers.

I must say parenthetically that it is disappointing that the insurance industry has gone to such lengths to indicate the effects of repealing the antitrust exemption. The insurance industry, the largest industry in America, owes it to the American people to freely compete in the free enterprise system. You would think that these bastions of free enterprise would recognize some responsibility, some obligation. But instead of that, they have gone out to their agents and misled the agents as to the impact of the repeal of the McCarran-Ferguson Act, and they have put out their paid propaganda to mislead the American people.

I don't know whether or not we will repeal the McCarran-Ferguson Act in 1988, in 1989, or in 1990, but it will be repealed. It will be repealed, because this industry has no right to continue to have this exemption. And if they have any concern for the free enterprise system for the people of America, for what is fair and what is right, then they will change sides and say, yes, indeed, we can compete freely.

We think everybody else should compete; we no longer have the right to have that exemption.

I hope that day is not far distant. I know that the House is acting on this measure for repeal. I am hopeful the Senate will do so. If we don't do it today, we'll do it tomorrow; if we don't do it tomorrow, we'll do it the day after; and if we don't do it the day after, the day is not far long in coming when we will repeal the antitrust exemption that the insurance industry has at this time.

Senator Simon, I am happy to see that you have joined us. Do you have an opening statement?

Senator SIMON. Thank you very, very much, Mr. Chairman.

I appreciate your leadership on this, and I welcome the witnesses. Let me just add, I had a chance to see some of Attorney General Abrams' work, and I appreciate that, and I had the pleasure of serving in the House with Jim Shannon and Jim Mattox, now distinguished attorneys general.

I would simply add, without commenting on the suit that is now pending, where I don't have the detailed knowledge, that if the insurance agency continues to resist any change in the unwarranted exemption they have in the antitrust laws now and the McCarran-Ferguson provision, then that train is going to come running down the track and may do harm to an industry that is very important to the future of this country.

The abuses are real; no question about it. And we have a job to protect the American public here in Congress; you have a job as attorney general to protect the public in your States.

I want to see sensible legislation. But to my friends in the insurance industry who are gathered here, let me just say that that train is coming down the track, and you can continue to pretend and resist any change, or you can help mold change to see that it is constructive, that it takes away, frankly, some of the exemptions that you now have in the law, but also sees to it that we do not do damage to an industry that is very, very important to the future of this country.

I hope out of this hearing and out of the lawsuit that is pending that we can move in a direction that really does protect the American public better than they are now protected.

Thank you, Mr. Chairman.

Senator **Metzenbaum**. Thank you, Senator Simon. We do appreciate your support and enjoy working with you on this, as on so many other matters.

The rule we will follow today with respect to time of our witness is that with respect to the first panel there will be 10 minutes for each participant, with respect to the second panel there will be 10 minutes, and with respect to the third panel, there will be 5 minutes for each participant.

Before I call the first panel, I wish to place into the record prepared statements of Senators Thurmond and Hatch, along with the text of S. 1299.

[The aforementioned material follows:]

STATEMENT BY SENATOR STROM THURMOND (R-S.C.) BEFORE THE SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS, SENATE JUDICIARY COMMITTEE, REFERENCE THE STATE ANTITRUST ACTIONS AGAINST THE INSURANCE COMPANIES, 226 DIRKSEN SENATE OFFICE BUILDING. TUESDAY, JUNE 14, 1988, 9:30 A.M.

MR. CHAIRMAN:

The hearing today is a contination of our examination of the insurance industry and the legislation that has been proposed to repeal the McCarran-Ferguson antitrust exemption. The focus of this hearing is the recent antitrust actions filed by nine State Attorneys General against 31 insurance companies and ISO, the Insurance Services Office.

As I have stated before, I do not favor repeal of McCarran-Ferguson because I do not favor any reduction in the ability of the states to regulate the insurance business. However, I intend to review with care any proposal which purports to reduce the antitrust immunity of the insurance industry without diluting or disrupting the authority of the states.

There has been much publicity about the antitrust actions filed by the State Attorneys General. Some of the Attorneys General have been forthright in their statements that one of the purposes of filing these cases is to seek repeal of McCarran-Ferguson and to restructure the insurance industry and ISO in particular. Regarding these lawsuits, the complaints allege that it was a conspiracy that led to the insurance liability crisis of 1984 through 1986. However, there are commentators who suggest a variety of other reasons for that crisis, such as the nature and extent of jury awards in tort litigation. The plaintiffs will have their day in court and will have the opportunity to convince a jury that their allegations are correct.

Mr. Chairman, I want to thank all our witnesses for their time and effort in appearing before us today.

-END-

STATEMENT OF SENATOR ORRIN G. HATCH

MCCARRAN-FERGUSON EXEMPTION/ANTITRUST LITIGATION
SUBCOMMITTEE ON ANTITRUST, MONOPOLIES, AND BUSINESS RIGHTS
JUNE 14, 1988

MR. CHAIRMAN, ONCE AGAIN WE GATHER TO HEAR TESTIMONY ON THE CAUSES OF THE LIABILITY CRISIS OF THE EARLY 1980'S AND TO EXAMINE THE ADVISABILITY OF PROPOSALS TO REPEAL THE MCCARRAN-FERGUSON EXEMPTION TO THE ANTITRUST LAWS.

IT IS USEFUL AND IMPORTANT TO EXAMINE THE CAUSES OF THE RECENT LIABILITY CRISIS IN PROPERTY/CASUALTY INSURANCE. NO ONE DISPUTES THE DEVASTATING IMPACT OF THE AVAILABILITY AND AFFORDABILITY CRISIS: BUSINESSES IN ALL OF OUR STATES EXPERIENCED CANCELLATIONS, NON-RENEWALS, AND WALK-OUTS IN A WIDE VARIETY OF PROPERTY/CASUALTY INSURANCE LINES, INCLUDING CHILD CARE, MUNICIPAL LIABILITY, AND MEDICAL MALPRACTICE.

HOWEVER, FOCUS ON ANTITRUST LITIGATION AGAINST INSURANCE COMPANIES, IS UNLIKELY TO ASSIST US IN ARRIVING AT CONSTRUCTIVE SOLUTIONS TO AVERT LIABILITY CRISES IN THE FUTURE. SOME HAVE ALLEGED THAT INSURANCE COMPANIES CONSPIRED TOGETHER TO NARROW COVERAGE UNDER STANDARD COMMERCIAL LIABILITY POLICIES. OTHERS HAVE ARGUED THAT HIGH INTEREST RATES A FEW YEARS AGO TRIGGERED

EXCESSIVE COMPETITION FOR PREMIUMS THAT MIGHT BE INVESTED AT A HIGH RATE OF RETURN AND THAT THIS EXCESSIVE COMPETITION CAUSED INSURERS TO SELL THEIR PRODUCT TOO CHEAPLY.

THE CONSPIRACY THEORY CONFUSES ME IN A NUMBER OF RESPECTS. THE ALLEGED CONSPIRACY INVOLVED THE DEVELOPMENT OF NEW POLICY CLAIMS-MADE FORMS AND YET IT IS MY UNDERSTANDING THAT LESS THAN 5% OF ALL GENERAL LIABILITY COVERAGE WRITTEN TODAY IS UNDER CLAIMS-MADE POLICIES. MOREOVER, THIS THEORY DOES NOT EXPLAIN THE CRISIS OF RISING INSURANCE RATES. NOTHING IN THIS ALLEGED CONSPIRACY RELATES TO PRICING, OR THE AFFORDABILITY CRISIS. IN ADDITION, THIS THEORY DOES NOT EXPLAIN WHY SOME INSUREDS WERE UNABLE TO BUY ANY COVERAGE AT ANY COST, WHICH IS OFTEN REFERRED TO AS THE AVAILABILITY PORTION OF THE CRISIS. EVEN THE TIMING OF THIS ALLEGED CONSPIRACY IS PROBLEMATIC. WE ARE TOLD THE LIABILITY CRISIS WAS ALREADY IN FULL SWING IN 1984, THE YEAR IN WHICH THIS "HISTORIC" CONSPIRACY OCCURRED, AND THAT MOST STATE REGULATORS FAILED TO APPROVE THE NEW FORM BEFORE 1986. IN THE FACE OF THIS INFORMATION, IT IS DIFFICULT TO UNDERSTAND HOW THIS ALLEGED CONSPIRACY COULD HAVE CAUSED THE LIABILITY CRISIS.

AS TO THE EXCESSIVE COMPETITION THEORY, I AM INDEED IMPRESSED WITH THE EVIDENCE OF STRONG COMPETITION IN THE INSURANCE INDUSTRY. I UNDERSTAND THAT THERE ARE SOME 3,500 INSURANCE COMPANIES IN BUSINESS AND THAT THE TOP FIVE COMPANIES

DO NOT EVEN ACCOUNT FOR 25% OF THE INSURANCE BUSINESS. EVEN IF THE HIGH INTEREST RATES PRESENT A FEW YEARS AGO TRIGGERED EXCESSIVE COMPETITION, IT IS DIFFICULT TO HARMONIZE THAT PROBLEM WITH THE PROPOSED SOLUTION -- REPEAL OF McCARRAN-FERGUSON. IF THE CAUSE OF THE PROBLEM IS TOO MUCH COMPETITION, IT WOULD SEEM ILLOGICAL TO ADVOCATE A CHANGE DESIGNED TO INCREASE THE LEVEL OF COMPETITION.

FINALLY, WHILE THE ALLEGATIONS OF THIS ANTITRUST LITIGATION SHED LITTLE LIGHT ON THE CAUSES OF THE INSURANCE CRISIS, THE LITIGATION DOES DEMONSTRATE THAT THE INDUSTRY IS SUBJECT TO THE ANTITRUST LAWS.

WITH THESE QUESTIONS IN MIND, I LOOK FORWARD TO THE TESTIMONY OF THE WITNESSES HERE THIS MORNING.

II

100TH CONGRESS
1ST SESSION

S. 1299

To amend the McCarran-Ferguson Act to limit the Federal antitrust exemption of the business of insurance, to reaffirm the continued State regulation of the business of insurance, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MAY 29, 1987

Mr. METZENBAUM (for himself, Mr. SIMON, Mr. BIDEN, and Mr. KENNEDY) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

---

A BILL

To amend the McCarran-Ferguson Act to limit the Federal antitrust exemption of the business of insurance, to reaffirm the continued State regulation of the business of insurance, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Insurance Competition Improvement Act of 1987".

FINDINGS AND DECLARATION OF PURPOSE

SEC. 2. (a) The Congress finds and declares that—

(1) the continued regulation and taxation by the several States of the business of insurance is in the public interest; and

(2) the Federal antitrust laws comprise an essential component of congressional policy in favor of competition and consumer protection, and the current broad exemption from the antitrust laws afforded the insurance industry has adversely affected free competition and consumers of insurance.

(b) It is the purpose of this Act to promote free competition among insurers and to protect consumers of insurance by modifying the current antitrust exemption of the business of insurance.

AMENDMENTS TO THE MCCARRAN-FERGUSON ACT

SEC. 3. (a) The first section of the Act entitled "An Act to express the intent of the Congress with reference to the regulation of the business of insurance", approved March 9, 1945 (15 U.S.C. 1011), commonly known as the McCarran-Ferguson Act, is amended by striking out the period and inserting in lieu thereof the following: "; but that a continued broad exemption of the business of insurance from the Federal antitrust laws is not in the public interest.".

(b) Section 2(b) of the McCarran-Ferguson Act (15 U.S.C. 1012(b)), is amended by striking out all after "insurance" the second place it appears and inserting in lieu thereof a period.

(c) Section 3 of the McCarran-Ferguson Act (15 U.S.C. 1013) is amended to read as follows:

"Sec. 3. (a) Except as provided in subsections (b) and (d), the antitrust laws shall apply to the business of insurance and to acts in the conduct of such business.

"(b) The antitrust laws shall not be construed to prohibit any agreement, understanding, or concert of action between or among insurers, any insurance advisory organizations or their members, any individual insurers or any other persons that is limited to—

"(1) collecting, compiling, and disseminating historical data on paid claims or reserves for reported claims from insurers or any other source, provided that such information is made available to an appropriate State regulatory agency;

"(2) preparing and filing policy forms and endorsements for voluntary use by individual insurers;

"(3) conducting research and on-the-site inspections in order to prepare classifications of public fire defenses; and

"(4) collecting, compiling, and distributing information relating to fraudulent claims and other fraudulent practices, provided that such information is made available to an appropriate State regulatory agency.

"(c) Nothing in this Act or any State law shall render the antitrust laws inapplicable to any agreement to boycott, coerce, or intimidate, or to any act of boycott, coercion, or intimidation.

"(d) Insurers and other persons participating in joint underwriting, pools, or residual market mechanisms may, in connection with such activity, act in cooperation with each other in the making of rates, rating systems, policy forms, underwriting rules, surveys, inspections, and investigations, if the residual market mechanism is required by law or is approved by and subject to the active supervision of an appropriate State regulatory agency, or if the joint underwriting or pools do not unreasonably restrain trade.

"(e) Nothing in this Act shall be construed to prohibit any State from establishing or approving a residual market mechanism.

"(f) Nothing in this Act shall be construed to prohibit any State from requiring a worker's compensation and employers' liability insurer to adhere to the uniform classification system and uniform rating plan applicable to these categories of insurance in such State, but no such insurer shall agree with any other insurer or with an insurance advisory organization to adhere to or use any rate.

"(g) As used in this section, the term—

"(1) 'advisory organization' means any organization which is comprised of, or is controlled by, one or more insurers and which prepares policy forms and endorsements for use by its members or subscribers, compiles and promulgates insurance-related statistical data, prepares and revises insurance rating plans and classification systems, and provides assistance in the preparation of insurance rates;

"(2) 'antitrust laws' means the Sherman Act (15 U.S.C. 1 et seq.), the Clayton Act (15 U.S.C. 12 et seq.), and the Federal Trade Commission Act (15 U.S.C. 41 et seq.);

"(3) 'residual market mechanism' means an arrangement, either voluntary or mandated by law, involving participation by insurers in the equitable apportionment among them of insurance which may be afforded applicants who are unable to obtain insurance through ordinary methods;

"(4) 'joint underwriting' means a voluntary arrangement established on an ad hoc basis to provide insurance coverage for a commercial individually rated risk under which two or more insurers contract with the insured at a price and under policy terms agreed upon between the insurers, or negotiated between the underwriter and the insured; and

"(5) 'pool' means a voluntary arrangement, other than a residual market mechanism, established on an ongoing basis, under which two or more insurers participate in the sharing of risks on a predetermined basis by means of an association, syndicate, or other pooling agreement.".

SEC. 4. (a) This Act and the amendments made by this Act shall become effective one year after the date of enactment.

(b) In any action brought under the provisions of the antitrust laws alleging a violation of those laws for conduct that would have otherwise been lawful under the provisions of the McCarran-Ferguson Act on the day before the effective date of this Act, no award of treble damages or criminal penalties shall be awarded against any such person for conduct by such person occurring within two years after the date of the enactment of this Act.

(c) During the two-year period referred to in subsection (b), no relief shall be granted against any person in an action referred to in subsection (b) for conduct by such person during such period, if such person has, in good faith, relied upon an advisory opinion issued by the Department of Justice.

○

Senator **Metzenbaum**. Mr. Abrams, would you proceed? We are happy to have you with us again.

STATEMENT OF A PANEL, INCLUDING: HON. ROBERT ABRAMS, ATTORNEY GENERAL, STATE OF NEW YORK, ACCOMPANIED BY LLOYD CONSTANTINE, CHIEF, ANTITRUST BUREAU; HON. JAMES M. SHANNON, ATTORNEY GENERAL, COMMONWEALTH OF MASSACHUSETTS; AND HON. JIM MATTOX, ATTORNEY GENERAL, STATE OF TEXAS

Mr. **Abrams**. Thank you very much, Mr. Chairman, Senator Metzenbaum, Senator Simon.

I appreciate very much this opportunity to address you concerning the coordinated antitrust complaints that were filed on March 22 by nine State attorneys general against major insurers, reinsurers and their trade associations.

Eight attorneys general filed Federal antitrust complaints in the Northern District of California. In addition to New York's lawsuit, those actions included the Attorneys General of Alabama, Arizona, California, Minnesota, West Virginia, Wisconsin, and by Attorney General Jim Shannon of Massachusetts, a former Member of Congress who joins us today, and Attorney General Jim Mattox of Texas, who is also a former Member of Congress who is testifying today; he filed a closely-related antitrust complaint in a State court in Texas.

Today, at 9:00 a.m. Pacific daylight time, 10 additional States will be filing antitrust complaints closely tracking those that have already been filed. These actions are being taken by the Attorneys General of Alaska, Colorado, Connecticut, Maryland, Michigan, Montana, New Jersey, Ohio, Pennsylvania and the State of Washington.

Although I am the president-elect of the National Association of Attorneys General and served 3 years as chairman of its antitrust committee, I speak today only for myself, with one important exception. I can restate the position of the National Association of Attorneys General that Congress should repeal the anomalous and anachronistic McCarran-Ferguson Act, thereby requiring the insurance industry to operate within the same basic competitive framework which has served American business and consumers so well.

Now, before discussing the relevance of our lawsuits to the repeal of McCarran-Ferguson, allow me to outline the lawsuits and the extensive investigation which provided the factual basis for these actions.

Our coordinated antitrust suits of March 22 were preceded by a five-State investigation of more than 2 years. It was the most extensive multi-State antitrust investigation ever conducted and eventually included the production and review of tens of thousands of documents and the interview of hundreds of witnesses both in the United States and the United Kingdom. It is the kind of investigation that one would expected to be mounted by the Federal antitrust enforcement agencies, when sufficient cause existed, and it clearly existed in this instance.

In 1985 and 1986, our country suffered a severe constriction in the supply of liability insurance coverage accompanied by staggering price increases, a condition commonly referred to as "the insurance crisis". In certain respects, this crisis conformed to a regular business cycle in the insurance industry.

First, there is a period of high interest rates which spawns wide availability of coverage and competitive pricing designed to attract premium dollars to be invested by insurers. This phase of the cycle is healthy, and it is normal in many industries where investment income is a significant factor. However, at times, companies can recklessly cut premiums and write foolish policies, a phenomenon known by the pejorative term, "cash flow underwriting".

A cash flow mentality took hold prior to the crisis, and insurers went so far as to write policies on catastrophes that had already occurred, such as the MGM Hotel fire in Las Vegas, hoping to make enough profit on investments to overcome the payout to victims which was manifestly inevitable.

When interest rates come down, insurers raise prices and limit the supply of insurance. So our recent insurance crisis bore a resemblance to a normal business cycle. However, that similarity was akin to the relationship of a hurricane to a spring breeze. The severity of the constriction in supply when interest rates came down in the early eighties was so great that thousands of municipalities and businesses could find no liability coverage at any price, and thousands of others paid premiums up to ten times higher than previous rates—often for much less coverage.

Clearly, given the importance of the insurance industry and the simple fact that neither the business of Government nor the business of business can operate without casualty and property coverage, it would have been prudent for the Federal antitrust agencies to inquire into whether collusion played any role in this insurance crisis.

The interest of the Department of Justice should have been piqued by the insurance industry, because a basic rule for antitrust prosecutors is that recently deregulated industries or industries which are partially exempt from antitrust law are fertile fields for illegal collusion.

It is very easy and tempting for those who have been allowed to legally meet, discuss, and collectively determine terms of trade to take the next improper step. However, neither the severity of the insurance crisis and its attendant suffering, nor the structural warnings, were sufficient to motivate the Justice Department.

Instead, the head of the Antitrust Division merely observed that collusion was implausible in a liability market with roughly 1,000 companies, and there was a refusal to investigate.

In the face of that Federal inaction, we in the States did what we have done time and again in the antitrust arena over the last few years——

Senator **Metzenbaum**. Excuse me. Who was the head of the Antitrust Division at that time?

Mr. **Abrams**. Rick Rule, and he is still the present incumbent, Senator.

Our 2-year investigation disclosed a market with approximately 3,500 firms, but one where there were certain very large carriers like the ones that we have sued, and several so-called "choke points" where the influence of a few actors in the market can control the behavior of the entire market.

Two such choke points were the reinsurance and retrocessional reinsurance markets. Reinsurance is insurance that is purchased by insurers themselves to help pay claims that they in turn must pay. And similarly, retrocessional coverage is insurance for the reinsurers.

These markets are much more concentrated than the primary insurance market, especially in relation to certain lines of insurance risks such as liability coverage for municipalities. Collusion at the reinsurer and retrocessional reinsurer level is much more plausible and can choke off and raise the price of primary insurance coverage.

Certain trade associations such as the ISO and the Reinsurance Association of America can also be focal points for collusion and act as choke points. In particular, ISO produces standardized insurance forms, including a Commercial General Liability Form, which dominates the market, in that most insurance policies actually duplicate the ISO form verbatim or in some instances modify it in the slightest way.

This is because ISO not only produces a standard form, but maintains a national statistical base to follow the performance of its forms in terms of premiums collected and claims and defense costs paid out.

ISO also files its forms with State regulatory agencies and will shepherd these forms through the often complex approval procedures. ISO even suggests premiums to be charged.

The London reinsurance market was another choke point where relatively few actors controlled so-called "reinsurance treaties" on certain crucial lines of primary insurance coverage in North America. The London reinsurers operate in a different system where collusive activity, which is anathema to American antitrust law, is common and indeed encouraged.

The States therefore focused the investigation on these choke points and found abundant evidence of illegal collusion. We uncovered meetings, oral agreements and even written agreements, which are very rare and hardly even seen by antitrust prosecutors.

All of the collusive behavior which we have described with great particularity in our lawsuits involves either activity which does not meet the legal definition of the "business of insurance," is not regulated by State law, and/or constitutes acts of boycott, coercion or intimidation.

Therefore, in some or all of these respects, the alleged conduct is not in any way shielded by the McCarran Ferguson exemption.

Typical of the facts uncovered in the investigation and charged in the lawsuits is a written agreement signed by more than 40 reinsurers in which they pledge to refuse to reinsure any property reinsurance policy that contains a clause which covers pollution and seepage claims.

Senator **Metzenbaum**. Which covers what?

Mr. **Abrams**. Which covers pollution and seepage claims. This was the "smoking gun," Senator, and I have got a copy of that document with me. It is very rare that prosecutors will find a "smoking gun," a specific agreement, a letter of intent that lays out that these retrocessional reinsurers will not reinsure any reinsurer if they provide the kind of traditional seepage and pollution coverage. They must have an exclusion of that kind.

Senator **Metzenbaum.** I would like a copy of that for the record.

Mr. **Abrams.** I would be glad to provide that to you and the committee.

Another major focus of the conspiratorial activity was the attempt to eliminate so-called occurrence coverage in the market. A traditional occurrence form, which was the only type of coverage that was permitted by most States until the "crisis" provided the insured with coverage for any occurrence taking place during the policy term, even if a claim based upon such occurrence was not filed until many years later.

In contrast, so-called "claims-made" insurance only covers claims filed in the same year when the policy is in effect. It provides less coverage than the occurrence form.

Moreover, if you introduce a retroactive date into the claims-made form which coincides with the policy term, coverage is then provided only for accidents which occur during the policy term and the claim is also filed during the policy term.

Senator **Metzenbaum.** Mr. Abrams, can you wind up, please?

Mr. **Abrams.** Let me conclude, Mr. Chairman, by merely indicating that I think the action by the various States as a result of collective and independent investigation show that we have a very serious public policy issue before us. I commend you, Senator Metzenbaum, for your extraordinary leadership in seeking to lead the Congress in both Houses to remove this unnecessary exemption.

I think the lawsuits that we have brought highlight the need to address major reforms that are necessary in the insurance industry, and I am very pleased to be here with my colleagues to help highlight some of these concerns this morning.

[Statement of Mr. Abrams follows:]

STATEMENT OF

ROBERT ABRAMS

ATTORNEY GENERAL

NEW YORK STATE

BEFORE THE

SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY

UNITED STATES SENATE

CONCERNING THE

INSURANCE INDUSTRY ANTITRUST LITIGATION

JUNE 14, 1988

Chairman Metzenbaum and members of the Subcommittee. Thank you for this opportunity to address you concerning the coordinated antitrust complaints filed on March 22nd by nine state attorneys general against major insurers, reinsurers and their trade associations.

Eight attorneys general filed federal antitrust complaints in the Northern District of California. In addition to our lawsuit, actions were filed by the Attorneys General of Alabama, Arizona, California, Minnesota, West Virginia, Wisconsin and by Attorney General Jim Shannon of Massachusetts, a former member of Congress who joins me today. Attorney General Jim Mattox of Texas, who is also both a former member of Congress and testifying today, filed a closely related antitrust complaint in Texas state court.

Today at 9:00 A.M. Pacific Daylight time, ten additional states will be filing antitrust complaints closely tracking those already filed. These actions are being taken today by the Attorneys General of Alaska, Colorado, Connecticut, Maryland, Michigan, Montana, New Jersey, Ohio, Pennsylvania and Washington.

Although I am the President-Elect of the National Association of Attorneys General and served three years as Chairman of its Antitrust Committee, I speak only for myself today, with one important exception. I can restate the position of the National Associaton of Attorneys General that Congress should repeal the anomalous and anachronistic McCarran-Ferguson Act, thereby requiring the insurance industry to operate within the same basic competitive framework which has served American business and consumers so well. Before discussing the relevance of our lawsuits to the repeal of McCarran-Ferguson, allow me to outline the lawsuits and the extensive investigation which provided the factual basis for these actions.

Our coordinated antitrust suits of March 22nd were preceded by a five state investigation of more than two years. ~~duration.~~ It was the most extensive multistate antitrust investigation ever conducted and eventually included the production and review of tens of thousands of documents and the interview of hundreds of witnesses in the United States and the United Kingdom. It is the kind of investigation that one would expect to be mounted by the federal antitrust enforcement agencies, when sufficient cause existed, and it clearly existed in this instance.

In 1985 and 1986, our country suffered a severe constriction of the supply of liability insurance coverage accompanied by staggering price increases, a condition commonly referred to as "the insurance crisis." In certain respects this crisis conformed to a regular business cycle in the insurance industry. First, there is a period of high interest rates which spawns wide availability of coverage and competitive pricing designed to attract premium dollars to be invested by insurers. This phase of the cycle is healthy and normal in many industries where investment is a significant factor. However, at times companies can recklessly cut premiums and write foolish policies, a phenomenon known by the perjorative term "cash flow underwriting". A cash flow mentality took hold prior to the crisis and insurers went so far as to write policies on catastrophes that had already occurred, such as the MGM Hotel fire in Las Vegas, hoping to make enough profit on investments to overcome the payout to victims which was manifestly inevitable.

When interest rates come down, insurers raise prices and limit the supply of insurance. So our recent insurance crisis bore a resemblance to a normal business cycle. However, that similarity was akin to the relationship of a hurricane to a spring breeze. The severity of the constriction in supply when interest rates came down in the early 80's was so great that thousands of municipalities and businesses could find no liability coverage at any price and thousands of others paid premiums up to ten times higher than previous rates - often for much less coverage.

Clearly, given the importance of the insurance industry and the simple fact that neither the business of government nor the business of business can operate without casualty and property coverage, it would have been prudent for the federal antitrust agencies to inquire into whether collusion played any role in this insurance crisis.

The Department of Justice has designed a public educational program called "Think Antitrust". It tells local governments to be vigilant for collusion when severe supply restriction or price increases do not have obvious explanations. If the Antitrust Division had heeded its own manual during the insurance crisis it would have seen and heard many red flags and bells. Moreover, their interest should have been especially piqued by the insurance industry, because a basic rule for antitrust prosecutors is that recently deregulated industries or industries which are partially exempt from antitrust law are fertile fields for illegal collusion. It is very easy and tempting for those who have been allowed to legally meet, discuss and collectively determine terms of trade to take the next improper step. However, neither the severity of the insurance crisis and its attendant suffering nor the structural warning signals were sufficient to motivate the Justice Department. Instead the head of the Antitrust Division merely observed that collusion was implausible in a liability market with roughly 1000 companies and refused to investigate. In the face of federal inaction, we in the States did what we have done time and again in the antitrust arena over the last few years and took the burden upon ourselves.

Our two-year investigation disclosed a market with approximately 3500 firms, but one where there were certain very large carriers like the ones we have sued and several so-called "chokepoints" where the influence of a few actors in the market can control the behavior of the entire market.

Two such chokepoints were the reinsurance and retrocessional reinsurance markets. Reinsurance is insurance purchased by insurers to help pay claims that they in turn must pay. Similarly, retrocessional coverage is insurance for reinsurers.

These markets are much more concentrated than the primary insurance market, especially in relation to certain lines of insurance risks such as liability coverage for municipalities. Collusion at the reinsurer and retrocessional reinsurer level is much more plausible and can choke off and raise the price of primary insurance coverage.

Certain trade associations such as the Insurance Services Office ("ISO") and the Reinsurance Association of America can also be focal points for collusion and act as chokepoints. In particular ISO produces standardized insurance forms, including a Commercial General Liability form ("CGL") which dominates the market, in that most insurance policies actually duplicate the ISO form verbatim or only slightly vary it. This is because ISO not only produces a standard form but maintains a national statistical base to follow the performance of its forms in terms of premiums collected and claims and defense costs paid out. ISO also files its forms with State regulatory agencies and will shepherd these forms through the often complex approval procedures. ISO even suggests premiums to be charged.

The London reinsurance market was another chokepoint where relatively few actors controlled so-called "reinsurance treaties" on certain crucial lines of primary insurance coverage in North America. The London reinsurers operate in a different system where collusive activity, which is anathema to American antitrust law, is common and indeed encouraged.

The States, therefore, focused the investigation on these chokepoints and found abundant evidence of illegal collusion. We uncovered meetings, oral agreements and even written agreements which are only rarely, if ever, seen by antitrust prosecutors. All of the collusive behavior which we have described with great particularity in our lawsuits involves either activity which does not meet the legal definition of "the business of insurance", is not regulated by state law and/or constitutes acts of boycott, coercion or intimidation. Therefore, in some or all of these respects the alleged conduct is not shielded by the McCarran-Ferguson Act.

Typical of the facts uncovered in the investigation and charged in the lawsuits is a written agreement signed by more than 40 reinsurers in which they pledge to refuse to reinsure any property reinsurance policy that contains a clause which covers pollution and seepage claims.

Other causes of action stated in the complaints relate to agreements to boycott pollution and seepage coverage in CGL forms and an attempt to require the insured to pay the costs for defending a claim from within the policy limits. With traditional coverage, the insurer pays defense costs in addition to paying a claim adjudicated to be valid up to the policy limit.

Another major focus of the conspiratorial activity was the attempt to eliminate so-called occurrence coverage in the CGL market. A traditional occurrence form, which was the only type of coverage permitted by most states until the "crisis", provided the insured with coverage for any occurrence taking place during the policy term, even if a claim based upon such occurrence was not filed until many years later. In contrast, so-called "claims-made" insurance only covers claims filed in the same year when the policy is in effect. It provides less coverage than the occurrence form. Moreover, if you introduce a retroactive date into the claims-made form which coincides with the policy term, coverage is then provided only for accidents which occur during the policy term and the claim is also filed during the policy term. If a traditional occurrence policy is a one pound block of chocolate, then a claims-made form with a retroactive date and a pollution exclusion is hardly even a candy kiss. One major object of the alleged conspiracies was to foist this type of debased and shrunken coverage on the American business community and upon local governments. This part of the conspiracies was more or less successful depending upon the particular state regulatory structure and the vigilance and sophistication of specific state regulatory agencies. In New York we were fortunate that our Insurance Department spared us from the full weight of this aspect of the conspiracies.

My colleagues, Attorneys General Shannon and Mattox will provide greater detail on the conspiracies alleged.

Let me now return briefly to the issues of McCarran-Ferguson and the federal response to the insurance crisis.

Our lawsuits raise a question concerning the necessity of repealing the McCarran-Ferguson Act, when we were obviously able to investigate and file these cases.

First, the McCarran Act is already being misused and misinterpreted by the defendants and McCarran may add several years on to the life of this litigation. More important, however, is the point previously touched upon, that McCarran permits collective activity which inevitably and manifestly spilled over into illegal collusion. The history of antitrust is rife with similar instances. If there is a legitimate and narrow basis for immunizing specific activity, such as the pooling of actuarial information, then it is incumbent upon the insurance industry to make that case and surrender the unnecessary and broader exemption they now operate under.

I am proud that in 1986 NAAG again took the lead in unanimously calling for repeal of McCarran-Ferguson and included such a repeal in our Model Antitrust Improvement Act of 1987. It is a lead that is just now being followed by other groups such as the American Bar Association, whose Antitrust Section is now seeking to make its opposition to McCarran a position of the entire Association.

I am gratified and honored to have been part of a continuing effort whereby States have joined together on a non-partisan and bi-partisan basis to deal with these national problems and take action demanded by the public interest.

Senator **Metzenbaum**. Mr. Abrams, thank you for your testimony. As usual, it is on the point, and you state the case very well.

Let me ask you this. Simply stated, what has been the impact of the collusive behavior which you have alleged the insurance industry engaged in?

Mr. **Abrams**. There have been multiple impacts, Senator Metzenbaum, all against the public interest.

First of all, the price of insurance has risen dramatically. We have evidence in New York State, for example, that some municipalities, counties, towns, villages, paid nine times the premium value, nine times the amount that they previously paid for insurance, and they got less coverage; they paid much more for a shrunken product.

Many municipalities were not able to get any insurance whatever, so they were laid bare. They are at this very moment vulnerable. We do not even know how vulnerable they are, because in years to come, there will be lawsuits filed against these governmental entities that will impact on the taxes that they will have to levy on their constituents because they are going to have to be making payments years into the future.

Many activities were curtailed. Physical athletic programs, recreational activities, school districts. You will hear, I think, in a later panel from the experts with respect to the school boards of the entire State, the impact on school districts. Some had to cut back on programs; others had to lay off and fire teachers. It has had a very dramatic negative impact on the public policy and life of our communities.

Senator **Metzenbaum**. In a simple, concise statement, what did the insurance industry do that you allege was wrong?

Mr. **Abrams**. We alleged a conspiracy to alter the traditional form of coverage that was provided in the marketplace, broad occurrence coverage. They limited it.

If I might analogize it, I think we remember when we were growing up, we could buy a big Hershey bar, a pound Hershey bar, that could be broken up into bits and given to other members of the family. If that could be analogized to that product, the insurance policy, it was reduced to perhaps Hershey Kiss, but yet the price for this Hershey Kiss was nine times the price that you normally paid for that huge, one-pound Hershey bar.

The kind of insurance product or policy that was available in the marketplace was far-reduced and far-shrunken, increased in price, nine to ten times the cost in many instances, and for some, they couldn't even get any insurance whatever. That is a very serious situation. That is why it was an insurance crisis which arrived on the front pages of newspapers and magazines several years ago, gripping this country.

Senator **Metzenbaum**. The industry says there was no illegal collusion, since what was done was approved by State regulators. You say in your statement that ISO shepherds form and rate changes through the State approval process.

Isn't it really ISO that dominates the States, and not the other way around?

Mr. **Abrams**. That is correct. And I think a good example is what happened in New York. We have an aggressive insurance superintendent, James Corcoran. In the midst of the insurance crisis, he held a hearing. There was evidence and testimony given to him. But it was not truthful, it was not accurate. And in fact, that hearing remained open, and it has not been formally closed. We have cooperated with Superintendent Corcoran. So the kind of information that was provided to regulators—and I must say that we are proud that in New York, the superintendent did not allow a complete alteration of the historic and traditional kinds of coverage that was provided in the industry—so the regulating government entities certainly did not get the benefit of accurate information from the industry.

Senator **Metzenbaum**. Isn't it pretty much the practice with respect to most State regulators that the insurance companies, through ISO, just file and sell, and that the insurance commissioner, contrary to the opinion of many Americans, does not actually say, that's a fair rate or that's an unfair rate, but rather, it's just a matter of filing, and only under extraordinary circumstances does the insurance commissioner get into the question of what is fair and what is not fair?

Mr. **Abrams**. It varies from State to State, Senator, but you are absolutely correct in saying that that is the prevailing rule in most States. It is a mere filing requirement without any regulatory review or approval process.

Senator **Metzenbaum**. You obviously wouldn't have brought these cases if you didn't think you could win them, and I congratulate you on your ability to conceptualize a case that gets itself around the antitrust exemption of the McCarran Act. But won't the exemption still make your job that much harder to make out your case?

Mr. **Abrams**. Sure. The fact that there is an exemption written in the law gives an opportunity for insurance companies to claim that exemption. We of course feel that that is a bogus argument, that there is not a valid claim of exemption here. The reinsurance industry, for example, is not regulated at all. Also, the *Noerr-Pennington* doctrine is not applicable under this set of facts and circumstances.

We think that the State action doctrine, for example, could not be used and applied here.

So we think that there will be no valid basis for a claim of exemption under McCarran-Ferguson. But if the Congress were to take your lead and eliminate that exemption altogether, which we feel is a matter of policy—it should not be given as a special privilege for one, single industry, and then in the future, in litigation or lawsuits—the industry would not be able to claim it and cloud issues in specific cases.

Senator **Metzenbaum**. Thank you very much, Mr. Abrams.

Mr. Shannon, we are very happy to have you with us, sir. We met before, and it is nice to have you here. I want you to excuse me. I must take an important phone call, and Senator Simon is going to preside for just a moment. I will be right back.

Mr. **Shannon**. Thank you, Mr. Chairman and members of the subcommittee.

I appreciate having the opportunity to testify before you again today, and to be with my colleagues, Bob Abrams and Jim Mattox.

I also appreciate the continued interest this subcommittee has shown in the range of legal and policy issues related to property/casualty liability insurance and in the lawsuit that we have brought.

Among the States that have joined in this action are representatives of the Northeast, the West Coast, the Midwest and the South. Both Republican and Democratic Attorneys General have filed. Such diversity has resulted from the fact that this is a national and international industry, and that the effects of the conspiracy described in our suit were felt across the country.

This morning I will briefly address three areas. First, I will outline the nature of our investigation and some of the factors which compelled us to take action in this area.

Second, I will outline our findings of collusive behavior in the property/casualty liability industry.

Finally, I will briefly discuss the implications of our findings for an issue now pending before this subcommittee—the future of the McCarran-Ferguson Act.

I am also pleased to note that Gerald Moody, who is the Town Counsel for the Town of Milford, Massachusetts, will be testifying as part of the next panel. The Town of Milford is one of the named plaintiffs in the Massachusetts suit.

My office originally became involved in this investigation, which was started by California and Texas, because of the devastating impact that the liability insurance crisis of the mid-1980s had in Massachusetts. We experienced cancellations, non-renewals and walk-outs in a myriad of property/casualty lines including day care, municipal liability, marine fisheries and medical malpractice. Premium increases for day care facilities rose by as much as 1,000 percent, despite virtually no claims. In Massachusetts, one out of four of our businesses had its commercial insurance cancelled or not renewed.

Further, median rate increases in Massachusetts for each line of liability insurance ranged from 25 percent to over 300 percent.

A second reason we got involved was the absence of any meaningful response to the liability crisis by Federal antitrust enforcement agencies. Historically, the States have primarily involved themselves with local matters. Here, however, despite tremendous dislocations in the liability insurance markets, there was no Federal response.

In the course of our investigation, we ran across no evidence of a Federal investigation. The State Attorneys General began investigating the insurance agency to fill the void left by the Federal Government.

Finally, the insurance industry is extremely large and is national and international in scope. The States joined forces in this investigation as we have in a number of other antitrust efforts to increase our effectiveness. With increasing frequency, State attorneys general are collaborating on antitrust matters involving problems of mutual concern.

We conducted a 2-year investigation in which we interviewed or deposed hundreds of witnesses. Over a dozen assistant attorneys general reviewed more than 100,000 pages of documents. We concluded, as our complaint alleges, that collusive conduct on the part of major players in the insurance and reinsurance industries resulted in the restriction of coverages in the market for Commercial General Liability Insurance.

I would now like to outline in more detail our findings of collusive behavior in the industry. I have a copy of our complaint and a fact sheet we prepared, and with your permission, I would like to submit these documents for the record.

Senator SIMON [presiding]. They will be entered in the record.

Mr. SHANNON. Thank you, Senator.

[Documents follow:]

ATTORNEY GENERAL--OFFICE COPY

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UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

COMMONWEALTH OF MASSACHUSETTS,
ex rel JAMES M. SHANNON,
ATTORNEY GENERAL,
TOWN OF HANOVER,
TOWN OF MILFORD

Plaintiffs

-against-

HARTFORD FIRE INSURANCE COMPANY,
ALLSTATE INSURANCE COMPANY,
AETNA CASUALTY AND SURETY COMPANY,
CIGNA CORPORATION,
INSURANCE SERVICES OFFICE, INC.,
PETER NORTH MILLER,
ROBIN A.G. JACKSON,
MERRETT UNDERWRITING AGENCIES MANAGEMENT, LTD.,
THREE QUAYS UNDERWRITING MANAGEMENT, LTD.,
JANSON, GREEN, LTD.,
EDWARDS AND PAYNE (U.A.) LTD.,
C.J. WARRILOW (U.A.)-HINE & BUTCHER LTD.,
J. BRIAN HOSE & OTHERS, LTD.,
HARVEY BOWRING, LTD. - MURRAY LAWRENCE & PARTNERS,
K.F. ALDER & OTHERS, (U.A.) LTD.,
D.P. MANN & OTHERS (U.A.) LTD.,
UNIONAMERICA INSURANCE CO., LTD.,
CNA RE (U.K.) LTD.,
TERRA NOVA INSURANCE CO., LTD.,
EXCESS INSURANCE GROUP LTD.,
KEMPER REINSURANCE LONDON LTD.,
CONTINENTAL REINSURANCE CO., (U.K.), LTD.,
THOMAS A. GREENE & CO., INC.,

EFL

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COMPLAINT

88 Civ.
ANTITRUST
CLASS ACTION
JURY DEMAND

BALLANTYNE, McKEAN & SULLIVAN, LTD., :
R.K. CARVILL & CO., :
GENERAL REINSURANCE CORPORATION, :
CONSTITUTION REINSURANCE CORPORATION, :
MERCANTILE & GENERAL REINSURANCE COMPANY OF AMERICA, :
PRUDENTIAL REINSURANCE COMPANY, :
NORTH AMERICAN REINSURANCE CORPORATION, :
WINTERTHUR SWISS INSURANCE COMPANY, :
REINSURANCE ASSOCIATION OF AMERICA, :

Defendants.

X

PRELIMINARY STATEMENT

The Commonwealth of Massachusetts, by its Attorney General, James M. Shannon, brings this action on its own behalf and on behalf of counties, municipalities and all other governmental entities in Massachusetts which normally purchase commercial general liability ("CGL") insurance and have been injured by defendants' violations of federal antitrust laws. Defendants include major insurance and reinsurance firms and their trade associations whose illegal collusion resulted in severe restrictions in the availability and affordability of insurance coverage for businesses and governmental entities.

The first four claims for relief concern the manipulation of the standard policy forms for coverage of commercial general liability risks. These forms, produced by defendant Insurance Services

Office, Inc. ("ISO"), dominate the markets for the general liability insurance purchased by most insurance consumers. Anti-consumer revisions were made in the ISO CGL forms as the result of boycotts, threats, intimidation and other coercive conduct by the defendants. Insurance coverage for pollution was completely excluded from the ISO CGL policy forms. Insurance coverage for prior events was also eliminated in the new ISO CGL "claims made" insurance form. Moreover, the defendants' conspiratorial and coercive conduct caused a severe market-wide constriction of CGL insurance coverage, such that this coverage was unavailable to many businesses and governmental entities.

The fifth claim alleges that defendant reinsurance companies and others conspired to boycott the "occurrence form" of ISO's CGL policy to coerce insurers into offering the "claims made" form which affords consumers of insurance services far less insurance coverage. The sixth and eighth claims allege that domestic and foreign reinsurers boycotted and withheld reinsurance from the coverage of pollution risks. The seventh claim concerns the conspiracy between ISO and other defendants to standarize both Umbrella and Excess insurance forms.

Plaintiff seeks declaratory and injunctive relief, and threefold the damages sustained as a result of defendants' conspiracies in unreasonable restraint of trade.

I

JURISDICTION AND VENUE

1. This complaint is filed and the jurisdiction of the court is invoked under the provisions of 28 U.S.C. §§ 1331 and 1337 and 15 U.S.C. §§ 15 and 26 for monetary, declaratory and injunctive relief for injuries caused by defendants' violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.

2. Venue is proper in this District under Sections 4 and 12 of the Clayton Act (15 U.S.C. §§ 15 and 22) and 28 U.S.C. § 1391 because each of the defendants transacts business, has agents, resides or is found within the Northern District of California; and certain of the defendants are aliens, as herein alleged.

II

DEFINITIONS

3. As used in this complaint, the following terms are defined as:

a. "Commercial general liability" (CGL) means insurance coverage for third party casualty damage claims against a purchaser of insurance (the "insured"). Purchasers of CGL insurance include governmental entities, not-for-profit corporations and businesses. CGL insurance does not include coverage for damage to the property of an insured.

b. "Occurrence form" means a liability insurance form that covers losses, whenever claimed, that occur during the policy period. The policy in force when the injury or loss occurs pays the claim, even if the claim is made after the policy has expired. Prior to 1984, occurrence coverage was the principal form used for all classes of CGL insurance.

c. "Claims-made form" means a CGL form under which the insurer is liable only for those claims made during the policy period. It does not cover any claim that is received after the expiration date of the policy, even if the accident or event giving rise to the claim occurred during the effective dates of the policy. Prior to 1984, the claims-made form was not ordinarily used for CGL insurance.

d. "Dual form availability" means the availability of two standard CGL forms: an occurrence form and a claims-made form.

e. "Retroactive date" (Retro Date) means a provision in a claims-made insurance contract which excludes coverage for accidents or events that occurred prior to the specified retroactive date.

f. "Defense within limits" (also referred to as "defense cost containment"; "defense cost within policy limits"; "defense cost cap") means a CGL policy provision which includes the insurers' defense costs as part of the stated policy limits. CGL insurance policies have historically included an obligation for the insurer to pay the full legal costs of defending a claim without regard to policy limits.

g. "Pollution exclusion" refers to the exclusion from the 1986 ISO CGL forms of all coverage for pollution claims, including claims alleging damage caused by "sudden and accidental" pollution. The 1986 ISO CGL forms eliminated all coverage for pollution exposures for plaintiffs herein.

h. "Tail" means the length of time during which an insurance company can expect to receive claims arising from a certain risk covered by the insurance policy. Claims arising from "slips and falls" present the insurer with "short tail" exposure since all such claims will generally be known within a short time after their occurrence. Claims arising from environmental hazards such as asbestos pollution present insurers with "long tail" exposure because claims may be filed many years after the occurrence giving rise to such claim.

i. "Risk" means the hazard or type of potential accident for which the insured seeks insurance protection. The term is also used within the industry to describe the insured itself, such as a "commercial risk" or a "municipal risk."

j. "Primary insurer" means an insurance company that sells insurance directly to consumers including businesses and governments.

k. "Insurance Services Office, Inc." or "ISO" is a not-for-profit corporation with offices in Quincy, Massachusetts and San Francisco, California, and elsewhere around the United States. ISO is a trade association for approximately 1,400 primary property/casualty insurance companies operating in the United States. One of ISO's functions is to develop standard policy forms and coverage parts for use by insurance companies.

l. "1973 ISO CGL form" means the standard CGL occurrence form and coverage parts developed by ISO in 1973, as amended prior to 1984.

m. "1984 ISO CGL forms" means the two CGL forms filed by ISO with state regulators in March 1984: an occurrence form and a claims-made form.

n. "1986 ISO CGL forms" means the two CGL forms filed by ISO with state regulators in 1986. These forms contained a complete pollution exclusion, and the claims-made form included a retroactive date.

o. "Reinsurance" means insurance for insurers. Reinsurance is a transaction whereby one insurance company, the reinsurer, agrees to indemnify another insurance company for a designated part of the insurance risks underwritten by the primary company.

p. "Treaty" means a contract by which a primary insurance company transfers to a reinsurer a portion of a category of risks which the primary insurer will obligate itself to cover during the term of the treaty.

q. "Layer" or "layer of coverage" means a portion of risk taken on by either a primary insurer or reinsurer. Risks are layered in the sense that an insurer or reinsurer may have to respond only to claims above a certain amount but below another amount. For example, a reinsurer may have a contract or treaty to cover risk indemnification in excess of $1 million but less than $2 million. The primary insurer, or ceding company, may retain the first million dollars in exposure, while other reinsurers may take on higher risk exposure layers, in this example layers above the $2 million level.

r. "Underwriting" means the act of assessing a risk and calculating a premium to be charged by a company or syndicate.

s. A "syndicate" is a group of individual investors associated with Lloyd's of London. Syndicates can act as both insurers and reinsurers. Each syndicate utilizes the services of an active underwriter to make its underwriting decisions and conduct all other insurance related business.

t. "Lloyd's of London" is a marketplace

composed of syndicates in London, England. Lloyd's syndicates compete for business both within Lloyd's and in the world-wide insurance and reinsurance markets. Lloyd's provides North American consumers with both reinsurance and insurance. Approximately half of Lloyd's casualty business involves North American risks.

u. A "lead underwriter" negotiates the terms of a reinsurance treaty which his syndicate or company will cover. A broker will then arrange for other syndicates or companies to join the treaty on the same conditions as that negotiated by the lead underwriter.

v. "London Company Market" means a group of insurance firms located in London outside of Lloyd's. These firms provide coverages for insurance and reinsurance, often by following the lead of a Lloyd's syndicate on the treaty in question.

w. "Sunset clause" means a provision included in a reinsurance treaty which limits the reinsurer's liability to those claims that are tendered by the primary company prior to a designated "sunset" date. Thus, a five year sunset clause means that the primary insurer will have no reinsurance coverage for claims presented later than five years after the inception of the treaty.

III

PLAINTIFFS

4. The Commonwealth of Massachusetts, by its Attorney General, James M. Shannon, brings this action on its own behalf, on behalf of the Towns of Milford and Hanover and the class represented by these towns as hereinafter described, and as parens patriae on behalf of the general welfare and economy of the Commonwealth of Massachusetts. The violations of federal law alleged herein have caused loss and damage, and threaten continued loss and damage, to the general welfare and economy of the Commonwealth of Massachusetts as well as to individual members of the plaintiff class.

IV

CLASS ACTION ALLEGATIONS

5. Plaintiff brings this action for declaratory and injunctive relief, and for damages pursuant to Rule 23(b)(2) and (b)(3) of the Federal Rules of Civil Procedure, on behalf of itself and all members of a class comprised of all those counties, cities, towns, political subdivisions, public authorities, public schools, school districts, public hospitals, and all other public entities within the Commonwealth, (except entities and institutions of the United States government,) that have purchased or sought to purchase CGL insurance from the defendants

or their co-conspirators during the period of the conspiracy alleged herein. It also includes public entities which, unable to purchase CGL insurance due to the actions of the defendants herein or their co-conspirators, sought and obtained other forms of indemnity protection from any source whatsoever (including self insurance).

6. Plaintiffs, Towns of Milford and Hanover are members of the class; their claims are typical of the claims of all class members; and they will fairly and adequately protect the interests of the class.

7. The class is so numerous that joinder of all members is impracticable. It consists of hundreds of governmental entities as described above.

8. The defendants have acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; questions of law and fact common to the members of the class predominate over any questions affecting individual members. The common questions of fact and law include the existence of the combination and conspiracies herein alleged, the extent to which members of the class were injured by the violations alleged, and the liability of defendants for the injury suffered by members of the class.

9. The claims of the named plaintiffs and other class members are identical, and the defenses will be identical with respect to each class member.

10. A class action is superior to any alternative method for the fair and efficient adjudication of this controversy.

V

DEFENDANTS

11. Defendants Merrett Underwriting Agencies Management, Ltd. ("Merrett Underwriting"), Three Quays Underwriting Management, Ltd. ("Three Quays"), Janson, Green, Ltd., Edwards and Payne (U.A.) Ltd. ("Edwards and Payne"), C.J. Warrilow-Hine & Butcher Ltd. ("Hine & Butcher"), J. Brian Hose & Others Ltd. ("J. Brian Hose"), Harvey Bowring Ltd.-Murray Lawrence & Partners ("Harvey Bowring"), K.F. Alder & Others (U.A.) Ltd. ("K.F. Alder"), and D.P. Mann & Others (U.A.) Ltd. ("D.P. Mann") are underwriters for syndicates doing business through Lloyd's of London. These defendants contract for their syndicates to provide reinsurance and insurance on property and casualty risks throughout the United States, specifically including Massachusetts and the Northern District of California.

12. Defendant Thomas A. Greene & Co., Inc. is a reinsurance broker based in New York with offices in San Francisco, California, which provides brokerage

services for the provision of reinsurance to insurance companies on risks in the United States and specifically including Massachusetts and the Northern District of California.

13. Defendants Ballantyne, McKean and Sullivan, Ltd. ("Ballantyne, McKean") and R.K. Carvill & Co. ("R.K. Carvill") are reinsurance brokers with offices in London, England who arrange reinsurance coverages for U.S. insurance companies at Lloyd's and in the London Company Market. These coverages concern risks located throughout the United States, specifically including Massachusetts and the Northern District of California.

14. Defendant Robin A.G. Jackson was, at all times relevant herein, the Chief Underwriter for Merrett Underwriting, and in particular, Syndicate 799. Jackson is a citizen of the United Kingdom and resident of London, England. As Chief Underwriter for Merrett Underwriting, Jackson provided reinsurance and insurance for casualty and property risks throughout the United States, specifically including Massachusetts and the Northern District of California.

15. Defendant Peter North Miller was, at all times relevant herein, the Chairman of the Council of Lloyd's of London, the governing body of Lloyd's. Miller is a citizen of the United Kingdom and a

resident of London, England. Miller conducted the business of Lloyd's of London and of the Council of Lloyd's throughout the United States, particularly including personal conduct of such business in the Northern District of California.

16. Defendants Terra Nova Insurance Co., Ltd. ("Terra Nova"), Unionamerica Insurance Co., Ltd. ("Unionamerica"), Excess Insurance Group, Ltd. ("Excess"), Kemper Reinsurance London, Ltd. ("Kemper Re (U.K.)"), Continental Reinsurance Co. (U.K.) Ltd. ("Continental Re (U.K.)"), and CNA Re (U.K.) Ltd. ("CNA Re (U.K.)") are underwriting companies within the London Company Market, which provide reinsurance for risks located throughout the United States, specifically including Massachusetts and the Northern District of California.

17. Defendants General Reinsurance Corporation ("General Re"), Constitution Reinsurance Corporation ("Constitution Re"), Mercantile and General Reinsurance Company of America ("Mercantile and General"), Prudential Reinsurance Company ("Prudential Re"), and North American Reinsurance Corporation ("North American Re") are United States corporations which provide reinsurance for risks throughout the United States, specifically including Massachusetts and the Northern District of California.

18. Defendant Winterthur Swiss Insurance Company

("Winterthur Swiss") of Winterthur, Switzerland, provides reinsurance for risks throughout the United States, specifically including in Massachusetts and the Northern District of California.

19. Defendants Allstate Insurance Company ("Allstate"), the Hartford Fire Insurance Company ("Hartford"), Aetna Casualty and Surety Company ("Aetna"), and CIGNA are United States corporations which provide insurance for risks throughout the United States, specifically including in Massachusetts and the Northern District of California.

20. Defendant Reinsurance Association of America ("RAA"), which has its headquarters in Washington, D.C., is a trade association of domestic reinsurers providing reinsurance on risks throughout the United States specifically including in Massachusetts and the Northern District of California. The RAA's principal business consists of lobbying activity, and the RAA conducts such activity in the Northern District of California.

21. Defendant Insurance Services Offices, Inc. ("ISO") is a not-for-profit corporation with offices in San Francisco, California; Quincy, Massachusetts; New York, New York and elsewhere around the United States. ISO develops rates and forms which are used by insurance companies in the sale of insurance throughout the United States specifically including

in Massachusetts and the Northern District of California.

VI

CO-CONSPIRATORS

22. Various persons, firms, corporations, or other business entities, known and unknown to plaintiffs, not named as defendants herein, have participated as co-conspirators with defendants in the violations alleged below and have performed acts and made statements in furtherance thereof.

VII

BACKGROUND

CGL Insurance, Reinsurance, State Regulation and ISO

A. CGL Insurance

23. Commercial General Liability ("CGL") insurance protects the insured from claims brought against it by others. For example, CGL insurance covers an accident involving a customer which occurs on a business' premises. The insured is the purchaser or consumer of the CGL insurance, and is also known as the "risk." CGL insurance is purchased by businesses, non-profit groups and governmental entities such as cities or counties.

24. The basic insurance arrangement for CGL coverages is familiar. The contract between the insurance company and the insured is called a policy. The policy is written on a document known as

a form. A policy is issued for a specific time period, e.g., one or three years, known as the policy period. Under the terms of the policy, the insurer agrees to pay valid claims which are covered by the policy. The insurer also agrees to pay a lawyer to defend the lawsuit and to bear other costs of the defense. The price the company charges for the policy is called a premium.

B. Reinsurance

25. Reinsurance is insurance for insurance companies. Only insurance companies (and self-insurance pools and similar groups) purchase reinsurance. The reinsurance company agrees to indemnify an insurance company for a portion of the risk originally assumed by the insurance company. The reinsurance company is known as the reinsurer and the insurance company is known as the primary, or ceding company.

26. Reinsurance takes a variety of forms. The type of reinsurance most pertinent to this Complaint is "treaty" reinsurance. Under a reinsurance treaty, the reinsurer agrees in advance with the reinsured to share a designated portion of specified classes of risks assumed by the reinsured during the treaty period. The treaty period may be any length of time, but is normally one year.

27. Reinsurance treaties are often underwritten

by a number reinsurers, each reinsurer assuming a percentage of the treaty obligations.

28. Reinsurance serves at least two different purposes. One is to protect the primary insurance company from catastrophic losses. The other is to allow the primary insurance company to sell more insurance than its own financial capacity might permit without the reinsurance.

29. The principal markets for the supply of reinsurance of North American CGL risks are in the United States, London, and the European continent. The most important part of the London market for CGL coverages is Lloyd's of London.

30. Lloyd's of London ("Lloyd's") is composed of syndicates. Syndicates are separately capitalized, independently operated, competing firms. Lloyd's itself is not an insurance company, but rather a marketplace or exchange where syndicates transact their business. A "Lloyd's of London" policy may be underwritten by dozens of individual syndicates, each sharing a portion of the risk. The Lloyd's market provides reinsurance, as well as direct coverage in certain other unregulated markets in the United States.

31. Reinsurance is purchased by primary insurers either directly, or through intermediary brokers. At Lloyd's, all reinsurance must be procured through a

Lloyd's broker, admitted to the floor at the Lloyd's market.

32. In reinsurance markets, certain underwriters or firms, known as "lead" underwriters, are recognized as having special expertise in certain classes and lines of risks. A lead underwriter is the first to sign the reinsurance treaty, and normally establishes with the primary company's broker, or "intermediary," the terms, conditions and price of the treaty. "Following" underwriters only join onto a treaty after a recognized lead reinsurer has signed off on the treaty. Lead underwriters therefore have an influence on the reinsurance market far beyond the percentage of the risks that they actually assume.

33. The availability of reinsurance affects the ability and willingness of primary insurers to provide insurance to their customers. Prudent insurers rely heavily on reinsurance to protect their balance sheets from unexpected losses.

C. State Regulation of Insurance

34. All fifty states regulate some aspects of the business of insurance. The extent of the regulation varies widely from state to state and depends on the type of insurance. Pursuant to state law, only "admitted" or licensed insurers such as defendants Hartford, CIGNA, Aetna and Allstate are

permitted to write CGL insurance, with one exception. That exception is for "surplus lines." Surplus lines are unusual lines of insurance for which coverage is nominally unavailable in the admitted market. For those lines, after the unavailability has been certified by a special broker, the policy may be written by a non-admitted company known as a surplus lines insurer. These non-admitted companies' policies are not regulated by the state.

35. States also do not regulate umbrella and excess coverage as to forms or rates. Umbrella and excess insurance can be written by either admitted or non-admitted insurance companies, and are used by insurance consumers to obtain higher levels of protection for other liability insurance they may purchase.

36. Unlike primary insurance companies, the business of reinsurance companies is not regulated by the states, with only certain limited exceptions concerning financial solvency.

D. Insurance Services Office

37. The Insurance Services Office, Inc. ("ISO") is a trade association consisting of approximately 1400 property/casualty insurers including defendants Hartford, Allstate, [illegible] and Aetna. The member companies of ISO write approximately 95% of all

casualty insurance written in the United States. ISO resulted from the 1971 merger of eleven different regional and national rating bureaus. ISO is headed by a Board of Directors and an Executive Committee which reports to the Board. Defendants Hartford, Allstate, CIGNA and Aetna were members of the ISO Board of Directors during the relevant time period herein.

38. ISO performs a variety of tasks for its member companies. Among other functions, it develops standard policy forms, collects historical loss and other data, projects future loss trends based on that data, and calculates advisory premium rates and rules for CGL and certain other lines of insurance.

39. ISO is headed by a Board of Directors and an Executive Committee which reports to the Board. Policy forms are developed by insurance company representatives sitting on committees such as the "Commercial Lines Committee." Defendants Hartford, Allstate, CIGNA, and Aetna all played leadership roles in the development of ISO CGL forms.

40. CGL insurance written by primary insurers in the United States, including defendants Hartford, Allstate, Aetna and CIGNA, is predominantly written on the ISO standard policy forms and policy form components (coverage parts).

41. The dominance of the ISO CGL forms results

from the monopoly position it has occupied since the 1971 merger referred to above. ISO also maintains a national statistical data base which records the actual performance ("loss history") of its policy forms in the marketplace.

42. For example with respect to the 1973 ISO CGL form, ISO collected, aggregated and interpreted data on the premiums charged, claims filed and paid, defense costs expended and many other categories of information which show precisely how this insurance product performed.

43. Applicable state law also permits ISO to act as a rating organization for its member companies. ISO projects future loss trends based on the data it has collected, and then calculates advisory rates for CGL and other lines of insurance.

44. Non-admitted companies in the surplus lines market often use ISO CGL forms, or parts thereof, to underwrite risks, including those of the plaintiff class.

VIII

TRADE AND COMMERCE AFFECTED

45. The activities of the defendants and their co-conspirators and the restraints which are the subject of this Complaint were and are within the flow of, and substantially affect interstate commerce, as more particularly described below.

46. During the period covered by this Complaint the defendant insurance companies sold CGL insurance throughout Massachusetts, California and the United States. Their customers included, among others, corporations engaged in interstate commerce as well as state and local governmental entities. In 1986 CGL insurance premiums in the United States were $24.1 billion. Defendants Hartford, Allstate, Aetna, and CIGNA sell CGL insurance in Massachusetts, California and throughout the United States.

47. Defendant reinsurance companies and syndicates provide reinsurance for CGL and property insurance policies for risks located throughout Massachusetts, California and the United States. Approximately one half of Lloyd's business covers North American risks. Income from U.S. CGL and property reinsurance premiums constitutes a substantial portion of all reinsurance premium income in both the U.S. and London.

48. During the period covered by this Complaint, the sale of CGL insurance and reinsurance involved the following, among other things:

a) Various channels of interstate communication, including telephone lines and the mails, were regularly used in the purchases of CGL and property insurance and reinsurance and in the development of the ISO CGL insurance forms described in this Complaint;

b) A substantial amount of the CGL and property insurance that was purchased by plaintiffs came from outside Massachusetts;

c) Insurance forms for the sale of CGL insurance were developed by defendant ISO and other defendants, which forms were submitted to the insurance regulators of each State of the United States;

d) A substantial quantity of CGL insurance was sold nationwide on forms developed by defendant ISO;

e) Each defendant insurance company purchases a substantial quantity of reinsurance from outside the state in which it is located.

49. The illegal conduct challenged herein has had and may be expected to continue to have a not insubstantial effect on interstate trade and commerce as described in this Complaint.

IX

FACTS

A. The 1973 ISO Occurrence Form

50. The conspiracies alleged herein occurred after ISO undertook to revise its standard CGL insurance form that had been in use since 1973.

51. The 1973 ISO form employed the traditional "occurrence" trigger of coverage that had long been

used for CGL insurance. The standard occurrence policy language obligated the insurance company to pay or defend claims, whenever made, resulting from an accident or "injurious exposure to conditions" that occurred during the period the policy was in effect.

52. The 1973 ISO form covered claims relating to "sudden and accidental" pollution.

53. Another key provision of the 1973 ISO CGL form was that legal costs of defending claims were borne by the insurance company rather than the insured. A 1973 CGL policy for $1,000,000 worth of insurance coverage would provide fully that much protection for the insured, even if it cost $500,000 or even $1,000,000 in legal expenses to defend the claim.

54. In 1977 ISO began a project to revise substantially the 1973 occurrence form. This process resulted in a new set of CGL forms submitted to state insurance regulators in March, 1984.

B. The 1984 ISO Forms

55. The 1984 ISO CGL forms differed from the 1973 ISO CGL form in one key respect relevant to this Complaint: for the first time ISO filed two alternative CGL forms, one with a traditional "occurrence" trigger of coverage and the second with a new "claims-made" trigger.

56. The "claims-made" concept was a major change in the way CGL insurance had always been written. The trigger of coverage for the occurrence form focused on when the accident or event itself occurred and it did not matter when the notice of the claim actually reached the insurance company. The trigger of coverage for the "claims-made" policy, on the other hand, was the receipt of the claim by the insurer. If the claim came in during the period the policy was in effect, it was covered. If the claim was filed after the policy had expired, it was not covered. Coverage for these future claims is entirely dependent upon the insured's ability to purchase claims-made CGL insurance in succeeding years.

57. The claims-made form provides much less protection against long tail losses than an "occurrence" form. It shifts the risk of uncertainty for claims filed in the future from the insurer to the insured. Claims-made policies can be used by insurers to cut off liability for claims reported in the future by refusing insurance renewals to insureds who experience an increased or unexpected trend in claims.

58. As originally filed by ISO, the 1984 claims-made CGL form did not include a "retroactive date" provision. The inclusion of a "retroactive

date" provision has the effect of cutting off all coverage for occurrences prior to the retroactive date. Without a retroactive date, an injury in 1976 that was not filed with the insurance company until 1984 would be covered by the 1984 claims-made policy.

59. Other key aspects of the two 1984 ISO forms, however, were identical to the 1973 CGL form. Most important, both new forms continued to cover damage caused by "sudden and accidental" pollution. In addition, legal defense costs would continue to be borne by the insurance company without regard to the policy limit.

60. Within ISO, defendant Hartford opposed the proposed CGL forms on the grounds that: (a) the occurrence form should have been eliminated entirely in favor of issuing solely a claims-made form; (b) the claims-made form should have included a standard retroactive date provision; (c) pollution coverage should have been totally excluded by elimination of the coverage for "sudden and accidental" pollution; and (d) defense costs payable under the policy by the insurer should have been limited by including defense costs within the policy limits. Defendant Allstate opposed the claims-made form because it contained no standard retroactive date provision.

61. The majority of ISO Executive Committee and Commercial Lines Committee members, however,

supported the proposed 1984 CGL forms and rejected the changes proposed by defendants Hartford and Allstate. On December 15, 1983 the new CGL forms were approved by the ISO Board of Directors. ISO filed the two new CGL forms with state regulators in March, 1984.

C. RAA'S Response to the 1984 Forms

62. After their positions were rejected by a majority of ISO, certain primary insurance companies, including defendants Hartford, CIGNA, Aetna and Allstate, exerted concerted pressure on ISO staff and other member companies in an effort designed to have the CGL forms withdrawn, and to restrict CGL coverage available to the consumer under any new forms.

63. On March 2, 1984 representatives of Hartford met with representatives of General Re, the largest American reinsurer. The purpose of the meeting was to formulate a joint strategy to force changes in the 1984 ISO CGL forms. At this meeting, Hartford and General Re agreed to either coerce ISO to adopt their demands or, failing that, to "derail" the entire ISO CGL forms program.

64. At an RAA Executive Committee meeting held March 13, 1984, in the furtherance of its agreement with Hartford, General Re initiated a coordinated effort with the RAA to force revisions to the 1984 ISO CGL forms program. As part of their effort, on

May 26, 1984, the RAA Executive Committee created a "CGL Committee" consisting of defendants General Re, Mercantile & General, Constitution Re, North American Re and Winterthur Swiss.

65. At a June 15, 1984 meeting of the RAA CGL Committee, defendants named in paragraph 64 agreed to boycott the 1984 ISO CGL forms to force the introduction of a retroactive date to the claims-made form, and a pollution exclusion and a defense cost cap to both forms.

66. In a letter to ISO dated June 19, 1984, the RAA announced that its members would not provide reinsurance for insurance written on the 1984 ISO CGL forms.

67. Defendants General Re and Hartford also enlisted president Thomas A. Greene of defendant Thomas A. Greene & Co., Inc. to announce the boycott message to ISO in a widely-reported speech to the ISO Board of Directors on June 21, 1984. Greene stated that no reinsurers would "break ranks" to reinsure the 1984 ISO CGL forms.

D. Lloyd's of London's Response

68. Defendants Hartford, Aetna, CIGNA and Allstate, in addition to conspiring with General Re and the RAA, also encouraged a boycott of the 1984 ISO CGL forms by key Lloyd's of London syndicates, including the lead underwriters for North American

casualty reinsurance. As with the RAA conspiracy, the common goal of the London reinsurers, as well as the primary insurer defendants, was to coerce ISO and its members to withdraw the 1984 ISO CGL forms and to issue a more restrictive form. The resulting anti-consumer restrictions would include an end to all coverage for pollution liability and the addition of a retroactive date in a new claims-made form.

69. Defendants Hartford, Allstate, CIGNA, Aetna and others communicated to several lead Lloyd's of London syndicates their desire to restrict the ISO CGL coverages. These syndicates included the defendant Merrett Underwriting, Edwards & Payne and Three Quays.

70. As early as April 23, 1984, ISO learned that defendant Robin Jackson of defendant Merrett Underwriting, a lead underwriter in the North American casualty reinsurance market, was planning to withhold reinsurance for primary companies using the new ISO forms.

71. In late May 1984, ISO, in recognition of Lloyd's of London's power as a reinsurer of the United States CGL market, arranged a visit to London in July, 1984 to explain and promote the new forms to the London market.

72. Prior to the July 1984 meetings, Hartford and Allstate enlisted the aid of intermediary brokers

N. Graham of R.K. Carvill, and Thomas A. Greene & Co. to maximize the London reinsurance market's pressure on ISO to change its CGL forms.

73. While ISO staff were in London to discuss the March 1984, ISO CGL forms, London reinsurers including Tim Holloway of J. Brian Hose & Others Ltd. and Cyril Warrilow of C.J. Warrilow - Hine & Butcher, Ltd., threatened a boycott of North American CGL risks unless four key demands were met:

(a) The elimination of any ISO CGL occurrence form;

(b) The addition of a retroactive date to a revised CGL claims-made form;

(c) The exclusion of any pollution liability coverage from any CGL form; and

(d) Defense costs within limits.

74. These demands were conveyed to ISO staff in meetings with individual syndicates and companies in the London market, and at a dinner at the Garrick Club hosted by ISO on July 4, 1984. In attendance at the dinner were the leading Lloyd's underwriters of U.S. casualty reinsurance, including Robin A.G. Jackson of the Merrett Syndicates, Richard Hazell of the Three Quays Syndicate, Charles Skey of Edwards and Payne, and Gale Coles of the Janson, Greene Syndicate. ISO staff reported that the dinner attendees were "almost militant" in their resolve to eliminate coverage of CGL risks on the occurrence form.

75. After returning from London, ISO staff met

with defendant Hartford at the Hartford headquarters in Connecticut. By this time the reinsurance boycott to force key changes to be made in the 1984 ISO CGL forms was known within ISO as "the Hartford problem." Defendant Hartford continued to insist upon the coverage restrictions described in paragraph 60 and 73.

76. Sometime between August 12 and August 22, 1984, ISO staff in a reversal of its own previous positions on these matters agreed to recommend that key provisions of the 1984 ISO CGL forms be reconsidered and revised as demanded. On August 23, 1984, under pressure from defendants, the ISO Commercial Lines Committee capitulated and reversed its prior positions on the retroactive date and pollution exclusion. Later the same day, the ISO Executive Committee agreed that a final decision on these revisions to the forms should await their next meeting on September 20, 1984.

E. The September 20, 1984 Agreement

77. As demanded on August 23, 1984 by defendants Hartford and Aetna, ISO invited representatives of both the foreign and domestic casualty reinsurance markets to the September 20, 1984 Executive Committee meeting. Never before had representatives of the domestic and foreign reinsurance markets been invited to speak at an ISO Executive Committee meeting.

78. Eight representatives of what were major sources of reinsurance for all ISO members were invited to attend the September 20 meeting and a dinner with the Executive Committee hosted by ISO the evening before:

(a) Ronald Ferguson and John Etling, chairman and president, respectively, of General Re;

(b) N. David Thompson, president of North American Re;

(c) George Nimmo, president of Prudential Re and the chairman of the RAA at the time;

(d) Andre Maisonpierre, president of RAA;

(e) Robin Jackson of Merrett Underwriting;

(f) Richard Hazell of Three Quays; and,

(g) Gale Coles of the Janson, Green.

ISO staff also contacted six other London reinsurers to encourage them to convey their views on the scheduled issues to Jackson, Hazell and Coles before the September 20 meeting.

79. During the evening of September 19, 1984, Ferguson and Etling of General Re, Thompson of North American Re, Nimmo of Prudential Re and chairman of the RAA, Maisonpierre, the RAA president, and ISO officers dined at the Board Room, a private club in New York City. At this dinner, the reinsurers communicated to ISO Board members present their agreed positions on the 1984 ISO CGL forms in

anticipation of ISO's Executive Committee vote the next day.

80. Of the eight reinsurer representatives invited by ISO, only Hazell and Coles could not attend the September 20 meeting. With this in mind, ISO then urged Hazell and Coles to convey their views to Jackson before the meeting. Jackson conferred with at least Hazell and Coles before attending the meeting at ISO's headquarters in New York.

81. At the ISO Executive Committee meeting of September 20, 1984, the foreign and domestic reinsurer representatives presented their agreed upon positions that there would be changes in the forms or no reinsurance.

82. As of September 20, 1984, ISO members were already aware of emerging capacity problems in the reinsurance markets and the difficulty they would face in the renewal of their casualty treaties for 1985. The reinsurance boycott at that time would be devastating for ISO's members.

83. After the reinsurance representatives spoke, the ISO Executive Committee voted to include a retroactive date in the claims-made form, to exclude all pollution coverage from both new forms, and to defer to a later date the revision of the forms to adopt defense cost containment. ISO did not change its existing plan to offer a new occurrence form

along with the new claims-made form. The 1984 ISO CGL forms were thus withdrawn from the marketplace and replaced with new forms which include the coverage restrictions insisted upon by the defendant reinsurer and insurance companies.

84. In furtherance of the agreements reached on September 20, 1984, defendants ISO, Hartford, Aetna, and a "London reinsurer" combined to form an "ISO Team" to market the new forms. This scheme included co-ordinated speeches before groups of insurance brokers and agents to convince them that an expanded reinsurance boycott (and thus loss of income to agents from loss of commissions) would ensue if the ISO forms were not approved. The scheme also included plans to effect their agreement to add a defense within limits provision to the CGL forms.

F. The Occurrence Form Boycott

85. Even after their victory at the ISO Executive Committee meeting on September 20, 1984, defendant Peter North Miller and defendant Lloyd's reinsurers, including Robin A.G. Jackson, Merrett Underwriting, Three Quays, Janson, Green, Edwards and Payne, as well as broker Ballantyne, McKean & Sullivan, Ltd., and co-conspirators, continued their attempt to eliminate the occurrence form as an option for most risks and to make the restrictive claims-made form the standard CGL policy form.

86. As a means of coercing the insurance market to accept the claims-made form, Lloyd's reinsurers employed two primary strategies:

(a) public and private pronouncements that there would be no reinsurance for primary insurers writing on the occurrence form, and,

(b) the redesign of reinsurance treaties to eliminate coverage for "long tail" risks, thereby leaving the primary insurer without reinsurance protection for claims reported in the future. This exclusion became known as the "sunset clause."

87. In furtherance of the first strategy, Lloyd's reinsurers, including lead underwriters Robin Jackson and Richard Hazell, collectively refused to write new treaties or renew long-standing treaties with primary U.S. insurers unless they were prepared to switch to the claims-made form. Primary insurers who did not evidence a strong intention to commit to claims-made were left without reinsurance coverage or with very low limits of coverage, even though the claims-made form itself had not been approved for use in many jurisdictions, including Massachusetts.

88. Representatives of Lloyd's, including defendant Peter North Miller as Chairman of Lloyd's, also appeared in various public forums and in the trade press to present the agreed position that Lloyd's of London was withdrawing entirely from the

business of reinsuring primary U.S. insurers who wrote on the occurrence form. In furtherance of this effort, Robin Jackson circulated a series of letters to brokers, clients and fellow reinsurance syndicates pressing for further changes in the ISO forms, including the elimination of the option of an occurrence form for any CGL risk.

89. A second stratagem employed by Lloyd's of London reinsurers, including defendants, was to impose a "sunset clause" restriction within their treaties with primary insurance companies that effectively eliminated coverage for "long tail" risks written on the occurrence form.

90. After the so-called "sunset date," reinsurance coverage expires and the U.S. primary insurer becomes fully answerable for all losses without the benefit of reinsurance indemnity. The "sunset clause" was intended to force primary insurers to stop writing occurrence coverage and to substitute claims-made coverage, for all risks except very small risks.

91. During 1985 and early 1986, London reinsurers, acting in conjunction with intermediary brokers, including defendant Ballantyne, McKean & Sullivan, Ltd., combined to impose sunset clauses in reinsurance treaties of U.S. primary casualty insurance written on an occurrence form basis.

G. The Pollution Liability Coverage Boycott

92. In addition to the boycott of the occurrence form in general, by no later than January 1, 1986, reinsurers in London also boycotted reinsurance for pollution liability coverage in particular, even if written on a claims-made form. This conspiracy had the effect of drastically restricting the availability and affordability of pollution liability coverage in the United States, including Massachusetts.

93. The boycott was accomplished by joint agreement between lead Lloyd's of London underwriters and leading reinsurance firms in the London company market to exclude all pollution liability coverage reinsurance treaties, beginning in 1985 and continuing to the present. Participating Lloyd's syndicates included the defendants Merrett Syndicates, Edwards and Payne, Hine & Butcher, Ltd., Harvey Bowring, K.F. Alder, and D.P. Mann. Participating London company market defendants included Unionamerica, CNA Re (U.K.) and Terra Nova.

94. On November 6, 1985, at a meeting of these lead underwriters at the offices of defendant Ballantyne, McKean and Sullivan, Ltd., those present agreed that all North American casualty reinsurance treaties, including coverage for CGL, would be written

with a total pollution exclusion.

95. The complete exclusion of pollution coverage from casualty reinsurance treaties had a direct impact on U.S. primary insurers and insurance buyers. Insurance consumers that had potential pollution liability exposures, such as municipalities, could not find primary insurers willing to provide even "sudden and accidental" coverage.

H. ISO's Withdrawal of Support for the 1973 CGL Forms

96. As a result of the boycott, coercion and intimidation described herein, ISO succeeded in obtaining regulatory approval in most states for its revised CGL forms, both a new revised occurrence form and the revised claims-made form.

97. The Massachusetts Insurance Commissioner has not approved the 1986 ISO CGL forms for use in Massachusetts. Admitted insurers are therefore not permitted to insure Massachusetts risks on these forms. Notwithstanding the absence of regulatory approval, insurers do write insurance in Massachusets, including for plaintiffs, on the 1986 ISO CGL claims-made form by writing such insurance through surplus lines affiliates, or, for multistate risks, by "moving" the insurance to a state where the insured has operations and where the claims-made form is approved.

98. On July 1, 1987, ISO officially withdrew its "support" of the 1973 CGL form for states that have approved the 1986 ISO CGL forms. "Support" in this context includes the normal data collection and actuarial services performed by ISO in aid of its member companies. Without such support, most ISO members cannot continue to use the 1973 occurrence form in such states, because it is very difficult and expensive for any single company to duplicate the critical ISO support functions.

99. Although many insurance consumers preferred the 1973 CGL forms, the market for this type of coverage has all but disappeared for certain categories of consumers, including governmental entities such as plaintiffs.

I. ISO's Standardized CGL Insurance Policy for the Excess and Umbrella Markets

100. Beginning no later than November 10, 1985, ISO staff and ISO members including defendants Hartford, Aetna and CIGNA agreed that ISO staff should begin developing standardized CGL umbrella and excess policy language. This decision was made despite the fact that ISO, as the trade association for admitted property/casualty primary insurance companies, plays no authorized role in the unregulated excess and umbrella market.

101. "Excess" insurance is a specialized form of insurance normally not offered by admitted insurers

on a regulated basis "excess" refers to a layer of insurance, a higher level of indemnity protection, that sits on top of either a self-insurance program, often referred to as a "retention" or a primary insurance policy. "Umbrella" coverage is similar to excess insurance and likewise is not normally offered on a regulated basis.

102. After the introduction of new standard ISO CGL forms, ISO began to receive pressure from domestic reinsurers, London reinsurers, and others to develop standardized policy language for CGL excess and umbrella forms which would conform with the 1986 ISO CGL forms.

103. On January 14, 1986, the ISO Board of Directors approved a recommendation that the ISO staff develop standardized excess and umbrella policy language for broad distribution.

104. Early drafts of the standardized policy language were written by defendant Allstate, co-conspirator Safeco, ISO staff and others. Comments were solicited and received from defendants, Merrett Underwriting, Three Quays, co-conspirator H.S. Weavers Underwriting Agencies, Ltd. (a leading London company market insurer) and others in the reinsurance and excess insurance market.

105. On June 15, 1986 the ISO Executive Committee released standardized CGL excess and umbrella policy

language with the following provisions, among others:

- a) a retroactive date in the claims-made version;
- b) an absolute pollution exclusion in both versions; and,
- c) defense costs within the policy limits for both versions.

J. The Pollution Property Coverage Boycott

106. Specialized reinsurers in London and the United States including defendants Edwards and Payne, Merrett Underwriting, Unionamerica, Terra Nova, Excess, Kemper Reinsurance London, and other unnamed co-conspirators, also agreed to boycott reinsurance and insurance policies for U.S. and Canadian property seepage and pollution exposures. This conspiracy had the effect of restricting the availability and affordability of property pollution coverage in the United States, specifically including Massachusetts and California.

107. The agreement to boycott the provision of property pollution insurance and reinsurance for North American exposures is memorialized in a document entitled "Non Marine London Market Agreement 1987" ("Market Agreement"). This Market Agreement is signed by over forty London market retrocessional reinsurers both at Lloyd's and in the London Company Market. Retrocessional reinsurance means reinsurance

for reinsurers, while "LMX" is an industry designation for those retrocessional reinsurers who specialize in reinsuring Lloyd's and the London Company Market.

108. The parties to the Market Agreement agreed to use their "best endeavors to ensure that all U.S.A. and Canadian exposed insurance/reinsurance business attaching on or after 1st January, 1987 will only be written where the original business includes a seepage and pollution exclusion wherever legal and applicable."

109. The Market Agreement to boycott property pollution coverage was subsequently agreed to by at least twenty-nine North American retrocessional reinsurers of the LMX market.

110. The agreed upon exclusion of seepage and pollution risks from property insurance and reinsurance policies had a direct impact on U.S. primary insurers and insurance buyers. Insurance consumers who sought coverage for property exposures were no longer able to find primary insurers willing to provide such coverage.

FIRST CLAIM FOR RELIEF

DOMESTIC CONSPIRACY

(Conspiracy of Primary Insurers, the RAA and Members of the RAA to Coerce ISO to Adopt Restrictive Terms and Conditions in its CGL Forms)

111. Plaintiff repeats and realleges each and

every allegation stated in paragraphs 1-67 above with the same force and effect as if here set forth in full.

112. In violation of Section 1 of the Sherman Act, 15 U.S.C. §1, the defendants RAA, General Re, Constitution Re, Mercantile and General, Prudential Re, North American Re, Winterthur Swiss, Hartford, Allstate, CIGNA, Aetna, Thomas A. Greene & Co., Inc. and other co-conspirators have engaged in an unlawful contract, combination and conspiracy in unreasonable restraint of trade and commerce in the market for reinsurance coverage of CGL risks and the market for primary coverage of CGL risks.

113. Such contract, combination and conspiracy has consisted of a continuing agreement, understanding and concert of action among such defendants and co-conspirators, the substantial terms of which were:

a. to restrict the terms under which reinsurance coverage would be provided for North American CGL risks; and,

b. to refuse to provide reinsurance coverage for CGL risks to force ISO to amend its proposed 1984 CGL forms to incorporate defendants' terms.

114. For the purposes of forming and effectuating such contracts, combinations and conspiracies,

defendants named in paragraph 112 and co-conspirators did those things which they combined and conspired to do, including but not limited to the following:

(a) conducting the meetings and discussions among themselves to agree on the terms under which they would reinsure CGL risks;

(b) agreeing to boycott the 1984 ISO CGL forms, to force ISO to amend the forms to comply with defendants' terms; and,

(c) coercing and intimidating ISO and ISO members to adopt the terms agreed upon by defendants.

115. This contract, combination and conspiracy has had the following effects, among others:

(a) the standard CGL coverage available to plaintiffs in Massachusetts excludes all pollution liability coverage;

(b) the standard CGL claims-made policy available to plaintiffs in Massachusetts excludes retroactive coverage;

(c) the price of pollution liability coverage, where it is available, has increased; and,

(d) competition in the market for pollution liability coverage and retroactive claims-made coverage has been unreasonably restrained.

SECOND CLAIM FOR RELIEF

FOREIGN CONSPIRACY

(Conspiracy of Lloyd's of London Reinsurers and Primary Insurers to Coerce ISO To Adopt Restrictive Terms and Conditions in its CGL Forms)

116. Plaintiff repeats and realleges each and every allegation contained in paragraphs 1-76 above with the same force and effect as if here set forth in full.

117. In violation of Section 1 of the Sherman Act, 15 U.S.C. § 1, the defendants Merrett Underwriting, Robin A.G. Jackson, Three Quays, Janson, Green, Edwards and Payne, Hine & Butcher, J. Brian Hose, J. Brian Hose, R.K. Carvill & Co., Hartford, Allstate, CIGNA, Aetna, Thomas A. Greene & Co., Inc., and other co-conspirators have engaged in an unlawful contract, combination and conspiracy in unreasonable restraint of trade and commerce in the market for reinsurance coverage of CGL risks and the market for primary coverage of CGL risks.

118. Such contract, combination and conspiracy has consisted of a continuing agreement, understanding and concert of action among such defendants and co-conspirators, the substantial terms of which were:

(a) to restrict the terms under which reinsurance coverage would be provided for CGL risks; and,

(b) to refuse to provide reinsurance coverage for CGL risks to force ISO to amend its 1984 ISO CGL forms to incorporate defendants' terms.

119. For the purpose of forming and effectuating such contracts, combinations and conspiracies, defendants named in paragraph 117 and co-conspirators did those things which they combined and conspired to do, including, but not limited to the following:

(a) conducting meetings and discussions among themselves to agree on the terms under which they would reinsure North American CGL risks;

(b) agreeing to boycott the 1984 ISO CGL forms to force ISO to amend the forms to comply with defendants' terms; and,

(c) coercing and intimidating ISO and ISO members to adopt the terms agreed upon by defendants.

120. The aforesaid contract, combination and conspiracy has had the following effects, among others:

(a) the standard ISO CGL policy available to plaintiffs in Massachusetts excludes all pollution liability coverage;

(b) the standard CGL claims-made policy available in Massachusetts excludes all retroactive coverage;

(c) the price of pollution liability coverage, where it is available, has been increased;

and,

(d) competition in the market for pollution liability coverage and retroactive claims-made coverage has been unreasonably restrained.

THIRD CLAIM FOR RELIEF

JOINT CONSPIRACY

(Conspiracy of Primary Insurers, RAA Members and Lloyd's of London Reinsurers to Coerce ISO to Adopt Restrictive Terms and Conditions in its CGL Forms)

121. Plaintiff repeats and realleges each and every allegation contained in paragraphs 1-84 above with the same force and effect as if here set forth in full.

122. In violation of Section 1 of the Sherman Act, 15 U.S.C. §1, the defendants Merrett Underwriting, Robin Jackson, Three Quays, Janson, Green, Edwards and Payne, RAA, General Re, Constitution Re, Mercantile and General, Prudential Re, North American Re, Winterthur Swiss, Hartford, Allstate, CIGNA, Aetna, Thomas A. Greene & Co., Inc. and other co-conspirators have engaged in an unlawful contract, combination and conspiracy in unreasonable restraint of trade and commerce in the market for reinsurance coverage of CGL risks and the market for primary coverage of CGL risks.

123. Such contract, combination and conspiracy has consisted of a continuing agreement, understanding and concert of action among such

defendants and co-conspirators, the substantial terms of which were:

(a) to restrict the terms under which reinsurance coverage would be provided for CGL risks; and,

(b) to refuse to provide reinsurance coverage for CGL risks to force ISO to agree to amend its 1984 ISO CGL forms to comply with defendants' terms.

124. For the purpose of forming and effectuating such contracts, combinations and conspiracies, defendants named in paragraph 122 and co-conspirators did those things which they combined and conspired to do, including, but not limited to the following:

(a) conducting meetings and discussions among themselves to agree on the terms under which they would reinsure CGL risks and jointly communicating those terms to the ISO Executive Committee on September 20, 1984;

(b) agreeing to boycott the proposed 1984 ISO forms to force ISO to amend its 1984 CGL forms to comply with defendants' terms; and,

(c) coercing and intimidating ISO and ISO members to adopt the terms agreed upon by defendants.

125. The aforesaid contract, combination and conspiracy has had the following effects, among others:

(a) the standard ISO CGL policy available to plaintiffs in Massachusetts excludes all pollution liability coverage;

(b) the standard CGL claims-made policy available in the Masschusetts excludes retroactive coverage;

(c) the price of pollution liability coverage, where it is available, has been increased; and

(d) competition in the market for pollution liability coverage and retroactive claims-made coverage has been unreasonably restrained.

FOURTH CLAIM FOR RELIEF

GLOBAL CONSPIRACY

(Conspiracy of ISO, Primary Insurers, RAA Members And Lloyd's of London Reinsurers to Standardize the Terms and Conditions of CGL Insurance Coverage)

126. Plaintiff repeats and realleges stated allegations contained in paragraphs 1 through 99 above with the same force and effect as if here set forth in full.

127. In violation of Section 1 of the Sherman Act, 15 U.S.C. § 1, the defendants ISO, Merrett Underwriting, Robin Jackson, Three Quays Underwriting Janson, Green, Edwards and Payne, RAA, General Re, Constitution Re, Mercantile and General Re, Prudential Re, North American Re, Winterthur Swiss, Hartford, Allstate, CIGNA, Aetna, Thomas A. Greene & Co., Inc., R.K. Carvill Co., Ltd., and other co-conspirators have engaged in an

unlawful contract, combination and conspiracy in unreasonable restraint of trade and commerce in the market for reinsurance coverage of CGL risks and the market for primary coverage of CGL risks.

128. This contract, combination and conspiracy consisted of a continuing agreement, understanding and concert of action among such defendants and co-conspirators, the substantial terms of which were:

(a) to eliminate pollution coverage from the 1984 ISO CGL forms, as had been demanded by the defendants named above;

(b) to eliminate retroactive coverage from the 1984 ISO CGL claims-made form; and,

(c) to agree to limit defense costs to the limits of the policy in any ISO CGL policy form.

129. For the purposes of forming and carrying out this contract, combination and conspiracy, the defendants named in paragraph 127 and co-conspirators did those things which they conspired to do, including, but not limited to:

(a) conducting meetings and discussions among themselves to agree on the terms to be included in the ISO CGL forms;

(b) agreeing to incorporate the claims-made retroactive date and the pollution liability exclusion language in the 1986 ISO forms; and,

(c) agreeing to further revise the ISO CGL forms to provide for defense cost within limits, but agreeing to delay such revision until the changes in the claims-made retroactive date and pollution exclusion language were introduced to the market and regulators, where necessary.

130. This contract, combination and conspiracy has had the following effects, among others:

(a) the standard CGL coverage available to plaintiffs in Massachusetts incorporates terms demanded by defendants, i.e., a pollution exclusion and a retroactive date;

(b) the price of pollution liability coverage and retroactive claims-made coverage, where it is available, has increased;

(c) competition in the markets for pollution liability coverage and retroactive claims-made coverage has been unreasonably restrained; and,

(d) defense within limits is, or will be, a standard provision of many CGL policies.

FIFTH CLAIM FOR RELIEF

OCCURRENCE BOYCOTT

(Conspiracy of Lloyd's of London Reinsurers to Coerce Primary Insurers to Offer CGL Coverage on a Claims-Made Basis)

131. Plaintiff repeats and realleges each and every allegation contained in paragraphs 1-95 above with the same force and effect as if here set forth in full.

132. In violation of Section 1 of the Sherman Act, 15 U.S.C. §1, the defendants Peter North Miller, Robin A.G. Jackson, Merrett Underwriting, Three Quays, Janson, Green, Edwards and Payne, Ballantyne, McKean & Sullivan, Ltd. and other co-conspirators have engaged in an unlawful contract, combination and conspiracy in unreasonable restraint of trade and commerce in the market for reinsurance coverage of CGL risks written on the occurrence form and the market for primary coverage of CGL risks on the occurrence form.

133. Such contract, combination and conspiracy has consisted of a continuing agreement, understanding and concert of action among such defendants and co-conspirators, the substantial terms of which were:

(a) to restrict the terms under which reinsurance coverage would be provided for CGL risks;

(b) to refuse to reinsure those CGL risks written on an occurrence form; and,

(c) to eliminate reinsurance coverage for "long-tail" risks covered by occurrence policies.

134. For the purpose of forming and effectuating such contracts, combinations and conspiracies, defendants named in paragraph 132 and co-conspirators did those things which they combined and conspired to do, including, but not limited to the following:

(a) conducting meetings and discussions among themselves to agree on the terms under which reinsurance would be made available for North American CGL risks;

(b) agreeing to structure, promote and publicize a boycott of reinsurance for North American CGL risks by refusing to reinsure any risks other than those risks written on a claims-made CGL form or by offering such reinsurance only when it was itself written on a claims-made basis;

(c) coercing and intimidating primary insurers to use the claims-made form and reject the occurrence form; and,

(d) coercing and intimidating individuals who had spoken to, or had reason to so address or might have commercial interest in speaking to regulatory or legislative bodies or officials concerning that body's or official's approval of the adoption or use of the claims-made CGL form so as to influence or determine said individual's presentation to said officials or bodies.

135. The aforesaid contract, combination and conspiracy has had the following effects, among others:

(a) the market for occurrence CGL coverage available to plaintiffs in Massachusetts was unreasonably restrained;

(b) occurrence CGL coverage became unavailable in Massachusetts for many risks, including municipal liability risks; and,

(c) the price of occurrence liability coverage, where it is available, has been increased.

SIXTH CLAIM FOR RELIEF

POLLUTION BOYCOTT I

(Conspiracy of Lloyd's of London Reinsurers, Brokers and London Company Market Reinsurers to Boycott Pollution Coverage)

136. Plaintiff repeats and realleges each and every allegation contained in paragraphs 1-95 above with the same force and effect as if here set forth in full.

137. In violation of Section 1 of the Sherman Act, 15 U.S.C. §1, the defendants Merrett Underwriting, Harvey Bowring, Ltd.-Murray Lawrence & Partners, K.F. Alder and Others (U.A.), Ltd., Edwards and Payne, D.P. Mann and Others (U.A.) Ltd., C.J. Warrilow-Hine & Butcher, Ltd., Unionamerica Insurance Company, Ltd., Terra Nova Insurance Co., Ltd., CNA Re (U.K.) Ltd., Ballantyne, McKean & Sullivan, Ltd. and other co-conspirators have engaged in an unlawful contract, combination and conspiracy in unreasonable restraint of trade and commerce in the market for casualty reinsurance coverage for pollution risks and the market for primary casualty coverage of pollution risks.

138. Such contract, combination and conspiracy has consisted of a continuing agreement, understanding and concert of action among such defendants and co-conspirators, the substantial terms of which were:

(a) to restrict the terms under which casualty reinsurance coverage would be provided for CGL risks; and

(b) to limit the availability of pollution coverage in U.S. primary casualty insurance.

139. For the purpose of forming and effectuating such contracts, combinations and conspiracies, defendants named in paragraph 137 and co-conspirators did those things which they combined and conspired to do, including, but not limited to the following:

(a) conducting meetings and discussions among themselves to agree on the terms under which they would reinsure North American CGL risks; and,

(b) agreeing to exclude from casualty treaty reinsurance written in London all pollution coverage for North American casualty risks.

140. This contract, combination and conspiracy has had the following effects, among others:

(a) pollution liability coverage has become almost entirely unavailable for the vast majority of casualty insurance purchasers in Massachusetts including plaintiffs;

(b) the price paid by plaintiffs for pollution liability coverage, where it is available, has increased; and,

(c) competition in the market for pollution liability coverage has been unreasonably restrained.

SEVENTH CLAIM FOR RELIEF

Conspiracy by ISO, Reinsurers and Insurers to Restrain Trade in the Commercial Umbrella and Excess Insurance Markets

141. Plaintiffs repeat and reallege each and every allegation contained in paragraphs 1-105 above with the same force and effect as if here set forth in full.

142. In violation of Section 1 of the Sherman Act, 15 U.S.C. § 1, defendants ISO, Allstate, Hartford, Aetna, Merrett Underwriting, and Three Quays, and unnamed co-conspirators have engaged in an unlawful contract, combination and conspiracy in unreasonable restraint of trade and commerce in the markets for commerical umbrella and excess insurance coverages.

143. Such contract, combination and conspiracy has consisted of a continuing agreement, understanding and concert of action among such defendants and co-conspirators, the substantial terms of which were to restrict terms and conditions under which insurance coverages would be available to

purchasers of commercial umbrella and excess insurances.

144. For the purpose of forming and effectuating such contracts, combination and conspiracies, defendants named in paragraph 142 and their co-conspirators did those things which they combined and conspired to do, including, but not limited to, the following:

(a) conducting meetings and discussions among themselves to agree to draft "Model" forms and policy language for both umbrella and excess insurance coverages; and,

(b) agreeing, drafting, and then promulgating such "Model" forms and policy language for use in the umbrella and excess insurance markets.

145. This aforesaid contract, combination and conspiracy has had the following effect, among others:

(a) Competition in the unregulated markets for commercial umbrella and excess insurance has been unreasonably restrained.

EIGHTH CLAIM FOR RELIEF

POLLUTION BOYCOTT II

(Lloyd's of London, London Company Market
and Domestic Retrocessional Reinsurer
Boycott of Property Pollution Coverages)

146. Plaintiff repeats and realleges each and every allegation contained in paragraph 1-110 above with the same force and effect as if here set forth

in full.

147. In violation of Section 1 of the Sherman Act, 15 U.S.C. § 1, the defendants Unionamerica, Terra Nova, Excess, Edwards and Payne, Kemper Reinsurance London, Merrett Underwriting, Continental Re (U.K.), and unnamed co-conspirators have engaged in an unlawful contract, combination and conspiracy in unreasonable restraint of trade and commerce in the market for property insurance coverages for seepage, pollution and contamination exposures situated in North America, including the Commonwealth of Massachusetts.

148. This contract, combination and conspiracy consisted of a continuing agreement, understanding and concert of action among such defendants and their co-conspirators, the substantial terms of which were:

(a) to restrict the terms under which property pollution insurance and reinsurance coverage would be provided for North American risks; and,

(b) to limit the availability of property pollution insurance and reinsurance for North American risks.

149. For the purpose of forming and effectuating such contracts, combination and conspiracies, defendants named in paragraph 147 and their co-conspirators did those things which they combined and conspired to do, including, but not limited to,

the following:

(a) conducting meetings and discussions among themselves to agree to coverage terms and exclusions for primary and reinsurance coverages for North American property insurance; and,

(b) agreeing to boycott the provision of all retrocessional reinsurance for any U.S. or Canadian primary or reinsurance property coverages unless the original insurance coverage included a seepage, pollution and contamination exclusion clause.

150. This contract, combination and conspiracy has had the following effects, among others:

(a) property insurance and reinsurance policies written in the U.S. and Canada, including in the Commonwealth of Massachusetts, now exclude a seepage, pollution and contamination clause;

(b) the prices for seepage, pollution and contamination property insurance coverages, where they are still available, have been increased; and,

(c) competition in the market for property seepage, pollution and contamination coverages has been unreasonably restrained.

PRAYER FOR RELIEF

Wherefore, plaintiffs pray for judgment as follows:

150. The court adjudge and decree that defendants and co-conspirators have engaged in an unlawful

combination and conspiracy in restraint of trade and commerce in violation of Section 1 of the Sherma Act.

151. Defendants, their officers, directors, employees, agents, successors, assigns, subsidiaries, members, and all other persons acting or claiming to act on their behalf, be enjoined from, in any manner, directly or indirectly, continuing, maintaining, or renewing the combination and conspiracy hereinbefore alleged, and from engaging in any other combination, conspiracy, contract, agreement, understanding, or concert of action having a similar purpose or effect, and from adopting or following any practice, plan, program, or device having a similar purpose or effect.

152. Defendant ISO and its member companies and their staff be enjoined from communicating directly outside the formal auspices of ISO, or other authorized rating bureau under applicable state law, concerning (a) rates, (b) standard policy form language, (c) choice of policy forms, or (d) terms and conditions of insurance, for any line, class or risk.

153. Defendant ISO and its directors, officers, employees, agents, and any other persons purporting to act on its behalf be enjoined from holding any meeting at the same time and location, or in coordination with, the meeting of any other trade association or group in the insurance industry.

154. Defendant ISO be enjoined to maintain accurate records of all attendees at every meeting of its Board, Executive Committee, or other committee or subcommittee meetings convened under the auspices of ISO and tape record each such meeting, including meetings held by conference call, and maintain such tape(s) for a period of at least five years after the date(s) of such meetings, and make such tape(s) available, upon written request, to the Antitrust Division of the Attorney General of plaintiff Commonmwealth of Massachusetts.

155. Defendant ISO be enjoined to maintain true and correct copies of all speeches, press releases, official publications, and other public statements by any officer, director, employee, agent, or other person acting on behalf of ISO, or acting in a capacity reasonably likely to be taken to be on behalf of ISO.

156. Defendant ISO be enjoined to issue forms or form coverage parts which include all of the elements of the original March 1984 CGL forms, as thereafter lawfully amended to include the following terms:

a. An automatic 60 day "mini-tail" for reporting claims;

b. Limitations upon an insurer's total freedom to advance the policy's retroactive date;

c. An automatic five year tail for

occurrences notified to insurer but not yet claimed;

d. An advisory endorsement to reinstate a policy's aggregate limits if an unlimited reporting "tail" is separately purchased;

e. A requirement that the insurer notify the insured of his right to purchase an unlimited reporting "tail" whenever the retroactive date of the policy is advanced; and,

f. Limitations of the amount of detail required in the notice by the insured which is required to activate the automatic 5-year "tail."

157. Enjoin defendant ISO to maintain statistical support for the 1973 ISO CGL form and for the 1984 ISO CGL form as provided in the preceding paragraph.

158. Enjoin defendant ISO to provide any and all data maintained by ISO or received by ISO to any person, firm, public agency, or other entity requesting such data, conditioned only on payment of a reasonable, cost-based fee.

159. Enjoin each and every defendant insurer and reinsurer specified in paragraphs 17, 18 and 19 from participating on any board or committee of ISO for five years.

160. Enjoin each and every defendant insurer and reinsurer specified in paragraphs 11, 14-19 from making any public announcements urging or recommending product restrictions, pricing behavior,

or changes in loss reserves.

161. Enjoin defendant ISO to maintain on its Board of Directors public-interest members appointed by the Court, which public-interest members shall constitute a majority of the Board of Directors, and which shall be provided adequate compensation and support to participate effectively in the business of the Board of Directors.

162. Order that defendant ISO be restructured in such manner as the Court determines is necessary to prevent further anti-competitive conduct.

163. Enjoin each defendant reinsurer and each member company of the defendant RAA from communicating directly or indirectly with any other insurer, save in a public announcement made in the legitimate press/media, that it is considering withdrawing or forebearing from reinsuring any primary insurer, or any line of insurance.

164. Enjoin each defendant reinsurer, defendant RAA, and its member companies from establishing any formal or informal committees or other groups of competing reinsurers, or from communicating among themselves, for purposes that include or contemplate any activity regarding any forms, coverage parts, rates, terms or conditions upon which primary insurers or reinsurers provide coverage for CGL risks.

165. Enjoin each and every defendant reinsurer

specified in paragraphs 17 and 18, and all members of the RAA, from communicating directly or indirectly outside a formal meeting of the RAA, or other legitimate trade organization, concerning rates, pricing, forms or other terms of insurance or reinsurance.

166. Enjoin defendant RAA to maintain accurate records of all attendees at every meeting at every Board, Executive Committee, or other committee or subcommittee meetings convened under the auspices of RAA and to tape record each such meeting, including meetings held by conference call, and maintain all such tape(s) for a period of not less than five years after the date(s) of such meetings, and make such tape(s) available, upon written request, to the Antitrust Division of the Attorney General of plaintiff Commonwealth of Massachusetts.

167. Enjoin each defendant Lloyd's of London reinsurer and each member of the RAA to withdraw, in writing, any requirements it has imposed on any primary insurer that it implement claims-made forms for its CGL lines of business or which declare or create a boycott of any line or class of insurance, or any coverage part, and to submit copies of all such withdrawals to the Court and the Attorney General of the plaintiff Commonwealth of Massachusetts.

168. Enjoin defendants as specified in paragraphs 17 and 18 herein from participating in any Board or committee of the RAA for five years.

169. Enjoin defendants Thomas A. Greene and Co., R.K. Carvill and Ballantyne, McKean & Sullivan from providing information to any reinsurer on the prices, terms, or conditions being imposed by any other reinsurer except as may be necessary in the course of negotiating a specific reinsurance contract on behalf of a specific, bona fide purchaser of reinsurance.

170. Enjoin each and every defendant engaged in the sale of insurance to consumers to divest itself of any and all reinsurance and brokerage affiliates, subsidiaries, or other operations, and enjoin said defendant from engaging in such operations in the future without leave of Court.

171. Enjoin each and every defendant operating as an admitted carrier in plaintiff Commonwealth of Massachusetts to divest itself of any and all surplus lines and non-admitted affiliates, subsidiaries, or other operations, and enjoin said defendant from engaging in such operations in the future without leave of Court.

172. Enjoin each and every defendant operating as a reinsurer to divest itself of any and all intermediary brokerage affiliates, subsidiaries, or other operations and enjoin said defendant from

engaging in such operations in the future without leave of Court.

173. Enjoin each and every defendant insurer and reinsurer from conditioning insurance or reinsurance on the insured's support for any action by any governmental entity or trade association.

174. Enjoin all defendants to develop individual antitrust compliance programs, and manuals detailing same, to be approved by the Court and to report on an annual basis for ten years to the Court and plaintiffs' counsel with regard to compliance efforts pursuant thereto.

175. Enjoin each and every defendant to establish and maintain a fund for the benefit of plaintiffs who have incurred injury for claims for which said plaintiffs would have had CGL coverage but for defendants' violations of law.

176. Plaintiffs be awarded three times the damages incurred by them as a consequence of the aforesaid conspiracy and combination, as determined by the Court.

177. Plaintiffs have such other and further relief as the nature of the case may require and the Court may deem just and proper.

178. Plaintiffs recover the costs of, and attorneys fees associated with, presenting this action, including reasonable and necessary

investigative costs.

DEMAND FOR TRIAL BY JURY

Pursuant to Rule 38(b), Federal Rules of Civil Procedure, and Rule 200-4, Local Rules, United States District Court, Northern District of California, Plaintiffs demand trial by jury for all of the issues pled herein so triable.

Respectfully submitted,

JAMES M. SHANNON
ATTORNEY GENERAL
COMMONWEALTH OF MASSACHUSETTS

By
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DATE: March 22, 1988

Pursuant to Local Rule 110-2(a) and 200-1 of this Court, the following Local Attorney is designated:

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ATTORNEY GENERAL

FACT SHEET ON THE MULTI-STATE PROSECUTION OF ANTITRUST VIOLATIONS IN THE INSURANCE INDUSTRY

March 22, 1988

The Attorneys General of seven states today filed antitrust actions charging various insurance companies, reinsurers, reinsurance brokers, trade associations, and officers of those organizations with manipulating the market for commercial insurance.

Complaints alleging violations of the antitrust laws were filed in federal court in San Francisco by Attorneys General Jim Shannon of Massachusetts, Robert Abrams of New York, Charlie Brown of West Virginia, Don Hanaway of Wisconsin, Hubert H. Humphrey III of Minnesota, and John Van de Kamp of California. A related complaint was filed in state court in Austin by Texas Attorney General Jim Mattox. It is anticipated that other states will join in the litigation, possibly by the end of this week.

The federal lawsuit charges that four U.S. insurers -- Allstate, Hartford, Aetna, and CIGNA -- conspired with members of Lloyd's of London, domestic reinsurers, and the Insurance Services Office (ISO) to reduce the coverage of the standard "commercial general liability" (CGL) policy. That is the liability insurance purchased by most businesses, public agencies, and nonprofit organizations. The complaints charge that the conspirators unlawfully exercised their market power to guarantee that no competitors could offer broader coverage than the reduced insurance they were supporting.

The prosecution was the result of a coordinated two-year multi-state investigation by the Attorneys General into the liability insurance crisis. In the course of the investigation, which was conducted throughout the United States and in London, hundreds of witnesses were interviewed and deposed and over 100,000 pages of documentary evidence were subpoenaed.

NATURE OF THE CONSPIRACY

In the late 1970's and early 1980's, the now familiar "insurance cycle" reached a low point, with prices falling and costs mounting. As interest rates rose, companies were increasingly willing to sell insurance at low prices, hoping to win larger shares of the market to obtain more premium dollars, which they intended to invest at high market rates and earn a profit before they were required to pay out on the policies. Insurers refer to this practice as "cash-flow underwriting." When interest rates began to fall, these companies found themselves with less investment income to cover their insurance losses. The problem was especially severe in commercial lines, where the long "tail" (the time between the writing of the insurance and the payment of claims) gave insurers longer use of policyholders' money and made pricing especially sensitive to interest rates.

Aggravating the freefall in profits was an increasing number of claims made by customers who had suffered "long-tail" injuries, injuries which by their nature were not discovered until long after exposure to a hazard, such as asbestos or Dalkon Shield injuries. The standard liability insurance policy provided that claims be paid on an "occurrence" basis -- if an injury occurred during the policy term, the insurance company was responsible for the claim, regardless of when the company learned about it. In some cases, companies found that they were facing unexpected claims on policies they had written many years earlier.

By the early 1980's, commercial insurers recognized that they had a problem. The Attorneys General allege in their complaints that a plan was hatched, initially at Allstate and Hartford, to sell a stripped-down insurance policy, thereby reducing the cost to the insurer. Allstate and Hartford gradually enlisted the assistance of other carriers, then of reinsurance companies, and finally of the insurance companies' trade association to guarantee that no U.S. insurer could, even if it wanted to, write the broader insurance that had been available.

THE SHRINKING INSURANCE POLICY

The conspiracy to shrink the commercial general liability insurance policy focused on three aspects of the policy: the period of coverage, the availability of insurance against pollution risks, and the payment of defense costs.

Period of Coverage. For years the standard insurance policy written in the United States was the "occurrence" form. It protected the insured from any losses that occurred during the term of the policy. Thus, an occurrence policy for 1986 would cover any accident that occurred in 1986, regardless of when the injury was discovered and regardless of when a claim was made on the policy.

In certain specialty lines, a different policy was sometimes in use, known as a "claims-made" policy. This policy defined coverage in terms of the date the claim of injury was made, regardless of when the injury occurred. To illustrate the two kinds of coverage graphically, the following time-line shows the coverage of an occurrence policy purchased in 1988:

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                             OOOO
                             CCCCCCCCCCCCCCCCCCCCCCCCCCCCCCCCCC
---------------------------------------------------------------
Beginning of time            1988                   End of time
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The O's represent the period in which a covered injury could occur. If it occurred any time in 1988, the insurance company would be obligated to pay as long as the claim was presented any time shown by the C's -- for an occurrence policy any time from 1988 on. In contrast, a claims-made policy would look like this:

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OOOOOOOOOOOOOOOOOOOOOOOOOOOOOOOOO
                             CCCC
---------------------------------------------------------------
Beginning of time            1988                   End of time
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A claim could occur anytime during the period represented by the O's and be covered by the 1988 policy as long as the claim was made during 1988, the period shown the the C's. The advantage to the insurance company of a claims-made form is, of course, that once the term of the policy ends, the company faces no surprises, it has in hand all the claims it will ever get. That advantage for the company is a disadvantage for the consumer, who faces uninsured claims after the term of the policy. The consumer wanting protection has two options: either renew for the next year with the same carrier or purchase special "tail coverage" at an additional charge.

But the companies were not content with this limitation. They still faced having to pay for past accidents not yet reported. Their next response was to impose a retroactive date ("retro date") in the claims-made policy form, a provision which limited the insurance company's liability to injuries which occurred before a certain date, typically the start of the policy term. Graphically, the claims-made form with the standard "retro-date" would look like this:

```
                              OOOO
                              CCCC
------------------------------------------------------------------
Beginning of time             1988                     End of time
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Obviously, the consumer is now buying a lot less coverage than the old occurrence-based policy provided. If the companies could charge anything close to the same premium they got on the old occurrence policy, they would enjoy vastly greater profits.

The claims-made policy with a retro-date had another advantage for the insurers. If you bought successive years' coverage from the same company, you got cumulative coverage dating back to the retro-date of the original policy. That meant that if you switched carriers, you'd lose several years' coverage, making consumers less likely to shop around for insurance, which in turn made it easier for companies to maintain higher prices.

Pollution Coverage. One type of injury that sometimes takes years to be discovered is environmental pollution. CGL policies in force through the early 1980's typically provided coverage for "sudden and accidental" pollution (like an accidental spill from a city's waste-treatment plant into a river) but not for gradual "seepage" (for example, from a landfill into a groundwater basin). Some carriers were concerned that the U.S. courts were interpreting "sudden and accidental" too broadly, and generally felt that pollution risks represented a problem they could do without. These companies urged that all pollution injuries -- including those caused by "sudden and accidental" events -- be excluded from the standard CGL policy.

Defense Within Limits. Historically, insurance policies guaranteed to indemnify the insured for pay-outs up to the policy limits and to defend the insured against unmeritorious claims. Thus, if you had a $1 million insurance policy and were sued, you were entitled to up to $1 million to pay a judgment or settlement plus the legal defense provided by the insurance company. As companies were spending more on their own lawyers, some wanted to have the legal defense costs counted against the policy limit. Thus, on a $1 million policy, if the insurance company spent $600,000 defending against a claim, it would be obliged to pay only $400,000 toward a judgment; if the judgment were $1 million, the insured would be liable for $600,000 were the policy to provide for defense within limits.

Any business can try to increase profits two ways: raising prices or reducing the product. The Attorneys General charge in their lawsuit that the insurance companies pursued the latter approach: reducing the product.

THE NEED FOR COERCION

For all the reasons that the stripped-down CGL policy was good for the seller, it was bad for the buyer. Most people don't want partial protection against catastrophic losses. The companies pushing the new, limited policy knew that if other companies were selling the former, full policy, nobody would buy their stripped-down model.

And there is no doubt that there were insurance companies ready, willing, and able to sell occurrence-based coverage with the standard pollution coverage and defense not deducted from policy limits. Therefore the companies had a problem: How do you sell a turkey when others are selling steak?

THE INSTRUMENT FOR COERCION: ISO

ISO and Market Power. The answer to the companies' problem was the Insurance Services Office (ISO), a trade association made up of 1,400 insurance companies that write about 95% of all the casualty insurance in the United States. One of the functions to which the companies put ISO is "forms development," the devising of standard forms for insurance policies of various kinds. One such standard policy form was the ISO CGL policy, which was the full occurrence-based policy being widely used.

Because of ISO's central role in the insurance industry, if those favoring the shrunken CGL policy could get ISO to approve it, and to abandon the old full-protection policy, virtually the entire industry could be expected to follow suit. The reasons for that expectation is that very few firms write enough insurance in any one line to give them a statistically valid basis for projecting experience and developing an appropriate price for coverage. Consequently, ISO was designated as a data depository for insurance companies. Many companies provide ISO with their individual pay-out experience, and ISO aggregates that data to recommend rates. (The rate-recommendation function of ISO, although anti-competitive and illegal in any other industry, is not a part of the Attorneys General's cases because the insurance industry has a special exemption from the antitrust laws that covers this conduct.)

For ISO's ratemaking function to work, the various companies have to be reporting pay-outs on comparable coverage. Therefore, ISO, in addition to its ratemaking activities, also develops and promulgates standard policy "forms," which most companies use as the basis for the policies they sell. Thus, the companies that were trying to eliminate the traditional broad policies from the market knew that if they could get ISO to withdraw the occurrence-based standard form and adopt instead the stripped-down claims-made form, they would not have to fear losing business to those selling the superior product.

The March 1984 CGL Forms. ISO's Commercial Lines Committee was in the process of updating the CGL policy, which had been in existence since 1973. Executives at Allstate and Hartford, who were among the leading firms favoring the shrunken CGL policy, decided to take advantage of the opportunity to have ISO -- and, with it, the whole industry -- switch to the stripped-down claims-made policy. They urged the committee to abandon occurrence-based coverage and provide "support" (meaning publish and collect data) for only a claims-made form with retro-date, no pollution coverage at all, and defense within limits.

These companies, however, were out-voted in ISO's Commercial Lines Committee, and again in the ISO Executive Committee, by insurers who favored broader coverage, fearing that consumers would refuse to buy the shrunken CGL policy. In November 1983 ISO's Commercial Lines Committee voted to adopt a claims-made policy with no automatic retro-date, with coverage for sudden and accidental pollution, and without the defense-within-limits provision. The committee also voted to approve a new occurrence-based CGL policy. Despite objections from Allstate and Hartford, the ISO Executive Committee and Board of Directors approved the decision, and in March 1984 ISO filed, on behalf of its members, the approved claims-made CGL policy with Insurance Commissioners in those states where such filings are required.

THE TOOLS OF COERCION: REINSURERS

Even before the March 1984 ISO filings, Allstate and Hartford, soon joined by CIGNA and Aetna, were lobbying within the insurance industry against the ISO CGL program. As it became clear their fellow insurers did not agree with them, Hartford and Allstate tried to force ISO to accept their position by organizing a threatened boycott of the new CGL policies by reinsurers.

"Reinsurance" is simply insurance for insurance companies. "Primary" insurers -- generally those companies who sell the policy to the insured -- minimize their risk by contracting with the reinsurer, agreeing to give the reinsurer a portion of the premium and getting in exchange an agreement from the reinsurer to pay a portion of the pay-outs if they exceed a specified level. Without reinsurance to spread the risk, each insurance company could write far fewer policies.

The Domestic Reinsurance Conspiracy. Throughout 1984, Hartford, Allstate, Aetna and CIGNA carefully orchestrated a symphony of protests and threats directed at ISO from their own firms and from reinsurers. General Reinsurance enlisted the assistance of the domestic reinsurance industry's trade association, the Reinsurance Association of America (RAA), in a coordinated series of protests and threats of boycott by virtually the entire U.S. reinsurance industry. In June 1984 the program was formalized with the creation in RAA of a CGL

Committee, which wrote to ISO and met with ISO officials, communicating threats of a boycott.

The Foreign Reinsurance Conspiracy. ISO staff, mindful of most members' fears that a diminished product could cost them business, resisted the boycott threats and sought to persuade reinsurers that the ISO forms were in their best interests. In response, the opponents took their conspiracy overseas, urging influential underwriters and brokers in London to join the chorus of objections and threats. The U.S. firms then pointed to their London echoes as further evidence that ISO's position was hopeless.

In July 1984 ISO staff went to London, expecting to sell reinsurers on the new CGL forms. Instead they ran into a buzzsaw. For five days the delegation heard the same chant: the only ISO-approved policy should be claims-made with a retro-date, total pollution exclusion, and defense within limits, and if ISO persists with its present forms, there will be a boycott by reinsurers.

The effect was predictable: The delegation reported to the ISO Executive Committee that "little, if any, reinsurance would be provided" for the new ISO policies.

The Joint Reinsurers' Conspiracy. Throughout 1984, the conspirators worked in increasingly close cooperation. By mid-summer they were approaching ISO together -- a formidable front appearing to speak on behalf of the whole domestic reinsurance industry, Lloyd's of London, and all non-Lloyd's reinsurers in London.

Yielding to the threats, ISO's Commercial Lines Committee voted on August 23, 1984, to recommend that ISO revise the CGL claims-made form to include the standard retro-date and a total pollution exclusion to both the occurrence form and the claims-made form.

The Global Conspiracy. In August and September 1984, ISO essentially joined forces with the foreign and domestic reinsurers to agree on what CGL forms ISO should approve. On September 20, 1984, the ISO Executive Committee met with representatives of RAA, General Reinsurance, two other domestic reinsurers, and the leading spokesman for the Lloyd's syndicates. At the conclusion of the reinsurers' presentation, the ISO Executive Committee voted to accept the recommendation that the March 1984 filings with the states be withdrawn and that the forms be revised to include a standard claims-made retro-date and total pollution exclusion.

The London Boycott of Occurrence Coverage. Although in 1982 Lloyd's had told ISO that it supported continued use of the occurrence form, by 1984 Lloyd's had become a center of opposition to the availability of any CGL insurance on an occurrence basis. Although Lloyd's of London is not a single firm but a market in which firms, called "syndicates," transact reinsurance business, by 1985 a uniformity of terms had emerged among all the Lloyd's syndicates, facilitated by extensive communications among them. Reinsurers were told that there would be no reinsurance for policies written on the occurrence form through the use of a mechanism known as a sunset clause.

Thus, even if a U.S. insurer wanted to write occurrence coverage, if it could get reinsurance at all, the coverage was offered only with a sunset clause that left the insurer exposed to a period without reinsurance that many companies would find unacceptable.

The London Conspiracy to Boycott Pollution Coverage. On November 6, 1985 Graham McKean, a prominent Lloyd's broker, hosted a meeting of six major Lloyd's underwriters and three major U.S. - owned underwriters operating in London. Together the nine putative competitors represented a majority of the London reinsurance capacity available to U.S. insurers. At the meeting the nine agreed that none of them would reinsure any American liability insurance covering pollution, seepage, or contamination. McKean then informed U.S. reinsurance brokers and primary insurers of the agreement, effectively warning them that they would be unable to obtain any reinsurance from London if they wrote policies covering pollution risks.

The London Conspiracy to Extend the Pollution Boycott to Property Insurance. Thus far, the conspiracies have focused on U.S. liability insurance. During the hard market of the mid-1980's, the reinsurers had been underwriting liability insurance separately from property insurance, the coverage against injuries to the insured's own property. In late 1986 forty London retrocessional reinsurers specializing in reinsuring property insurance -- two of them subsidiaries of U.S. primary carriers -- signed an agreement to boycott all pollution and seepage coverage in American property insurance.

This agreement was later agreed to by twenty-nine North American retrocessional reinsurers. (retrocessional reinsurers provide reinsurance to reinsurers). This agreement effectively completed the boycott of any pollution coverage, in both liability and non-liability insurance.

EFFECTS OF THE CONSPIRACIES

The months following these agreements saw an unprecedented evaporation of insurance in the commercial lines. Municipalities were among the hardest hit. Consistent with the objectives of the conspirators, Massachusetts cities, counties, and special districts found occurrence-based coverage virtually impossible to obtain. Many towns were forced into the surplus lines market. Pollution coverage disappeared. Many were forced by total unavailability or vast price-hikes to do without insurance -- insuring themselves or forming insurance pools with other agencies. And those agencies that could obtain stripped-down claims-based coverage faced enormous price increases that left them paying more than they had for an occurrence policy a year before.

Successful conspiracies to restrain trade tend to foster further collusive conduct, establish the conspirators' market power to coerce further concessions on pricing and other terms, and increase the likelihood that the restraints will spread to other markets. The success of these conspiracies could only have contributed to the wrenching dislocations that surged through the economy in the months that followed.

WHAT LAWS HAVE BEEN BROKEN?

The Sherman Act prohibits agreements among competitors. Any agreement between two or more firms to boycott somebody's business is a " per se" violation -- even if the agreement seemed reasonable, it is an unlawful restraint of trade.

Can't Insurance Companies Decide Not In Insure Certain Risks? Each primary insurer was entitled to decide that it would not write certain policies. Every reinsurer was entitled to decide not to reinsure certain risks. The antitrust violation lies in the agreement among competitors concerning what they would not insure.

State law specifically empowers each of the Attorneys General to sue on behalf of his state's public agencies to redress violations of the federal antitrust laws. Accordingly, in Massachusetts the lawsuit has been filed on behalf of the state, its municipalities, and other public entities.

GOALS OF THE LAWSUITS

The Attorneys General are asking the federal court to enjoin the defendants from further violations of law, to order broad structural relief that will prevent further abuses of market power, and to award money damages for those public agencies injured by the defendants. Among the requested relief:

- Fundamental restructuring of ISO, including:
    - replacement of a majority of its Board of Directors with public-interest representatives not affiliated with insurance companies;
    - opening up ISO's data to the general public
    - requiring ISO to support CGL policy forms

containing adequate protection for consumers

- banning the defendant insurers for five years from ISO's boards and committees.

-- Forcing the defendant insurance companies to operate either as primary insurers, reinsurers, or brokers, requiring them to sell off subsidiaries in the other fields, and prohibiting them from operating in both regulated and unregulated markets;

-- Limiting future communications among the defendants to legitimate business transactions;

-- Forcing the reinsurers to resume writing insurance they had agreed to boycott;

-- Requiring the defendants to contribute to a fund that would protect municipalities that could not get insurance from major losses.

Mr. **Shannon**. In general, there are four major charges in our complaint.

First, the complaint charges that various primary insurers conspired with reinsurers, reinsurance brokers and industry trade associations to force the Insurance Services Office to adopt more restrictive provisions in standard CGL forms. The complaint also charges that domestic and international reinsurers in both the property and casualty markets conspired to eliminate all pollution coverage. Third, the complaint charges that ISO and other defendants conspired to standardize both umbrella and excess forms. Finally, we charge that a conspiracy existed to force primary companies to write liability insurance on a claims-made basis only.

The first four causes of action in the complaint center on pressure applied to ISO to adopt more restrictive provisions in the CGL forms.

In 1977, ISO began a process to revise the 1973 occurrence form. Under that form, any injuries which occurred during the policy period will be covered by that policy regardless of when the claim is submitted. In 1984, ISO finalized and filed with State regulators two new CGL forms—both an occurrence form and a claims-made form. Under the claims-made form developed in 1984, the policy that is in effect when a claim is filed, regardless of when the injury occurred, will cover that injury.

The 1984 forms filed by ISO were unacceptable to a number of primary carriers including defendants Hartford and Allstate. In general, the position of the insurance company defendants who had opposed the firms within ISO was that the forms provided too much coverage for consumers.

They sought to limit coverage by incorporating an absolute pollution exclusion and defense costs within policy limits and by having a retroactive date added to the claims-made form.

The effect of the retroactive date would be to reduce the coverage under the claims-made policy to cover only those injuries which occur during the policy period and for which claims are submitted during the policy period.

In other words, the claims-made policy with the retroactive date cuts off both the prospective coverage available under the occurrence policy and the retrospective coverage available under the pure claims-made policy.

Hartford and Allstate were unsuccessful in having their demands incorporated in the forms filed by ISO in 1984. Hartford and Allstate then went outside of ISO to garner support to force ISO to change the forms to make them more restrictive. They conspired with both international and domestic reinsurance companies to pressure ISO to change the forms.

In short, this effort was successful.

In an historic meeting before the ISO Executive Committee on September 20, 1984, leading reinsurer representatives communicated their position to ISO on the changes they were seeking in the forms.

That very same day, the ISO Executive Committee voted to incorporate the retroactive date in the claims-made form, to exclude all pollution coverage from both new forms, and to defer to a later date the revision of the forms to adopt defense costs within policy limits. Within months, ISO withdrew the 1984 forms, which had been the result of 7 years' worth of development, and replaced them with the new forms which include the coverage restrictions insisted upon by the defendant reinsurer and insurance companies.

As we charge in our complaint, ISO, Hartford, Aetna and a "London reinsurer" then combined forces to market the new forms before insurance brokers, agents and regulators.

The complaint alleges that but for the conspiratorial conduct of the defendants, the original 1984 forms which offered the consumer much more coverage would be on the market today.

Since time is limited, I will address only two more of the claims, both related to the pollution coverage boycotts.

We allege two different instances where key players in the reinsurer market conspired to eliminate pollution coverage. In the first instance, on November 6, 1985, leading London providers of reinsurance met at a reinsurance broker's office in London and agreed for those present that all North American casualty reinsurance contracts, including coverage for CGL, would be written with a total pollution exclusion.

In the second instance, over 40 specialized insurers in both the United States and London agreed to use their "best endeavors to ensure that all U.S.A. and Canadian exposed insurance/reinsurance business attaching on or before 1st of January, 1987 will only be written where the original business included a seepage and pollution exclusion." That's a direct quote.

As you can see from the above examples, we have uncovered substantial evidence of collusion among players in the property/casualty industry to restrict commercial general liability coverage.

This has been a unique industry in which to conduct an antitrust investigation because of the limited exemption provided the insurance industry from the antitrust laws. That exemption has given the insurance industry limited protection from the antitrust laws since 1945.

Because of the McCarran-Ferguson Act, the focus of our investigation was on collusive activity that would fall outside of the exemption. Accordingly, the conspiratorial activity charged in our complaint is not afforded any protection under the Act.

The question arises as to what implications our lawsuit has for McCarran-Ferguson.

The findings of our investigation make it clear that what we have here is an industry with an almost cavalier attitude toward the antitrust laws.

After years of operating under the exemption, this industry seems to have lost the ability to distinguish the bright line between what is legal conduct under the antitrust laws and what is not.

I know my time has expired, so I will just say two things, Senator. The first is that we intend to pursue this suit vigorously, and as Mr. Abrams pointed out, several other States are joining us today. At the same time, we hope this committee is going to continue its efforts to look at repealing the McCarran-Ferguson exemption.

We have limited resources, and the Antitrust Division of the Justice Department, even if it were interested in looking, has limited resources. As long as we have this exemption on the books, this industry is going to act as if it were totally exempt from the antitrust laws, and the results are going to be further acts like we saw before on the part of the industry, which resulted in a drastic cutback on liability insurance coverage for consumers across the country.

Thank you, Mr. Chairman.

[Statement follows:]

STATEMENT

OF

JAMES M. SHANNON

ATTORNEY GENERAL

COMMONWEALTH OF MASSACHUSETTS

before the

SENATE ANTITRUST, MONOPOLY AND

BUSINESS RIGHTS SUBCOMMITTEE

June 14, 1988

STATEMENT OF JAMES M. SHANNON

ATTORNEY GENERAL OF THE COMMONWEALTH OF MASSACHUSETTS

Good morning. Thank you Mr. Chairman and members of the subcommittee. I appreciate having the opportunity to testify before you again.

I also appreciate the continued interest this subcommittee has shown in the range of legal and policy issues related to property/casualty liability insurance -- and in the lawsuit that we and other states have brought. Among the states that have joined in this action are representatives of the Northeast, the West Coast, the Midwest and the South. Both Republican and Democratic Attorneys General have filed. Such diversity has resulted from the fact that this is a national and international industry, and that the effects of the conspiracy described in our suit were felt across the country.

This morning I will briefly address three areas -- and then will be glad to answer any questions.

First, I will outline the nature of our investigation and some of the factors which compelled my office to take action in this area.

Second, I will outline our findings of collusive behavior in the property/casualty liability industry.

Finally, I will briefly discuss the implications of our findings for an issue now pending before this subcommittee:

the future of the McCarran Fergusen Act.

I am also pleased to note that Gerald Moody, who is the town counsel for the Town of Milford, Massachusetts, will be testifying as part of the next panel. The Town of Milford is one of the named plaintiffs in the Massachusetts suit.

* * *

My office originally became involved in the investigation started by California and Texas because of the devastating impact that the liability insurance crisis of the mid-1980's had in Massachusetts. We experienced cancellations, non-renewals, and walk-outs in a myriad of property/casualty lines including day care, municipal liability, marine fisheries and medical malpractice. Premium increases for day care facilities rose by as much as 1,000 percent despite virtually no claims. In Massachusetts, one out of four of our businesses had its commercial insurance cancelled or not renewed. Further, median rate increases in Massachusetts for each line of liability insurance ranged from 25 percent to over 300 percent.

A second reason we got involved was the absence of any meaningful response to the liability crisis by federal antitrust enforcement agencies. Historically, the states have primarily involved themselves with local matters. Here, however, despite tremendous dislocations in the liability insurance markets, there was no federal response. In the course of our two year investigation, we ran across no evidence of a federal investigation. The S~~s~~tate attorneys general began investigating the insurance industry to fill the void left by the federal government.

Finally, the insurance industry is extremely large and is national and international in scope. The states joined forces in this investigation as we have in a number of other antitrust efforts to increase our effectiveness. With increasing frequency, state attorneys general are collaborating on antitrust matters involving problems of mutual concern.

We conducted a two year investigation in which we interviewed or deposed hundreds of witnesses. Over a dozen assistant attorneys general reviewed more than 100,000 pages of documents. We concluded, as our complaint alleges, that collusive conduct on the part of major players in the insurance and reinsurance industries resulted in the restriction of coverages in the market for Commercial General Liability (CGL) insurance.

I would now like to outline in more detail our findings of collusive behavior in the property/casualty liability industry.

In general, there are four major charges in our complaint.

First, the complaint charges that various primary insurers conspired with reinsurers, reinsurance brokers and industry trade associations to force the Insurance Services Office (ISO) (the primary industry trade association) to adopt more restrictive provisions in standard Commercial General Liability forms. The complaint also charges that domestic and international reinsurers in both the property and casualty markets conspired to eliminate all pollution coverage. Third, the complaint charges that ISO and other defendants conspired to standardize both umbrella and excess forms. Finally, we charge that a conspiracy existed to force primary companies to write liability insurance on a claims-made basis only.

The first four causes of action in the complaint center on pressure applied to ISO to adopt more restrictive provisions in the CGL forms.

Briefly, in 1977 ISO began a process to revise the 1973 occurrence form. Under the occurrence form, any injuries which occur during the policy period will be covered by that policy regardless of when the claim is submitted. In 1984 ISO finalized and filed with state regulators two new CGL forms: both an occurrence form and a claims-made form. Under the claims-made form developed in 1984, the policy that is in effect when a claim is filed, regardless of when the injury occurred, will cover that injury.

The 1984 forms filed by ISO were unacceptable to a number of primary carriers including defendants Hartford and Allstate. In general, the position of the insurance company defendants who had opposed the forms within ISO (and who are the primary company defendants in our suit) was that the forms provided too much coverage for consumers. They had sought to limit coverage by incorporating an absolute pollution exclusion and defense costs within policy limits, and by having a retroactive date added to the claims-made form. The effect of the retroactive date would be to reduce the coverage under the claims-made policy to cover only those injuries which occur during the policy period and for which claims are submitted during the policy period. In other words, the claims-made policy with the retroactive date cuts off both the prospective coverage available under the occurrence policy and the retrospective coverage available under the pure claims-made policy. Hartford and Allstate were unsuccessful in having their demands incorporated in the forms filed by ISO in 1984.

Defendants Hartford and Allstate (later joined by Aetna and CIGNA) then went outside of ISO to garner support to force ISO to change the forms to make them more restrictive. They conspired with both international and domestic reinsurance ompanies to pressure ISO to change the forms.

In short, this effort was successful.

In an historic meeting before the ISO Executive Committee on September 20, 1984, leading reinsurer representatives communicated their position to ISO on the changes they were seeking in the forms.

That very same day, the ISO Executive Committee voted to incorporate the retroactive date in the claims-made form, to exclude all pollution coverage from both new forms, and to defer to a later date the revision of the forms to adopt defense costs within policy limits. Within months, ISO withdrew the 1984 forms, which had been the result of seven years worth of development, and replaced them with the new forms which include the coverage restrictions insisted upon by the defendant reinsurer and insurance companies.

As we charge in our complaint, ISO, Hartford, Aetna and a "London reinsurer" then combined forces to market the new forms before insurance brokers, agents and regulators.

The complaint alleges that but for the conspiratorial conduct of the defendants, the original 1984 forms which offered the consumer much more coverage would be on the market today.

Since time is limited, I will address only two more of the claims, both related to the pollution coverage boycotts. We allege two different instances where key players in the reinsurer market conspired to eliminate pollution coverage. In the first instance, on November 6, 1985, leading London providers of reinsurance met at a reinsurance broker's office in London and agreed for those present that all North American casualty reinsurance contracts including coverage for CGL would be written with a total pollution exclusion. In the second

instance, over 40 specialized reinsurers in both the United States and London agreed to use their "best endeavors to ensure that all USA and Canadian exposed insurance/reinsurance business attaching on or before 1st January, 1987 will only be written where the original business included a seepage and pollution exclusion..."

As you can see from the above examples, we have uncovered substantial evidence of collusion among players in the property/casualty industry to restrict commercial general liability coverage.

This has been a unique industry in which to conduct an antitrust investigation because of the limited exemption provided the insurance industry from the antitrust laws. That exemption, provided by the McCarran Ferguson Act, has given the insurance industry limited protection from the antitrust laws since 1945.

Because of the McCarran Ferguson Act, the focus of our investigation was on collusive activity that would fall outside of the exemption. Accordingly, the conspiratorial activity charged in our complaint is not afforded any protection under the Act.

The question arises as to what implications our lawsuit has for McCarran Ferguson?

The findings of our investigation make it clear that what we have here is an industry with an almost cavelier attitude toward the antitrust laws.

After years of operating under the McCarran Act exemption, this industry seems to have lost the ability to distinguish the bright line between what is legal conduct under the antitrust laws -- and what is not.

We can see this in the conspiracies I described earlier -- activity clearly outside that allowed under McCarran.

And we also see it in the response that is being prepared to our lawsuit. While the defendants have yet to file an Answer, we understand that they plan to assert the McCarran Ferguson Act as a defense.

One can't help but conclude from all of this that the exemption provided by McCarran is at least partly to blame for the industry's disregard for antitrust laws.

I testified last year before this Committee on eliminating the McCarran antitrust exemption (see Section 2(b) of the McCarran Ferguson Act (15 U.S.C. § 1012(b))). I still support the repeal of that section for the following reasons:

First, the special immunity should be repealed because it fosters collective conduct that harms consumer welfare.

Second, with the development of state action and commerce clause legal doctrines, the original justifications for the exemption no longer exists.

Third, states will -- as they should -- be able to continue to regulate the insurance industry. The application of the nation's antitrust laws to the industry is fully compatible with continued state regulation and taxation of this industry.

Fourth, repealing immunity will not eliminate joint activities that are authorized by the state or that encourage efficiency and competition.

As I mentioned earlier, the conspiracies charged in the complaint filed by the eight states are outside of the immunity granted in the McCarran Ferguson Act. However, I am firmly convinced that the Act is helping to foster an atmosphere where antitrust laws are not rigorously followed.

I hope this Subcommittee will agree that it is time to act to address this problem.

Thank you very much for inviting me to testify today. I will be happy to answer any of your questions.

Senator **Metzenbaum**. Thank you very much, Mr. Shannon. I wasn't able to hear all your testimony, although I did hear some of it from the other room, and I read just about all of it.

I guess I would say, after hearing you and Mr. Abrams and reading some preliminary material on this subject, that I don't know whether or not you are going to be able to prove your case in court. I practiced law long enough to know that sometimes there are fact situations that are indeed difficult to prove in a court of law and also to prove that it is a violation of the law.

But whether you make the proof or not, I can't think of any more persuasive or convincing evidence as to why the antitrust exemption should not exist for the insurance industry. Certainly, you didn't fabricate, you didn't dream up all of these charges. Mr. Abrams comes forth with a document. You did your investigations over in London as well, the whole question of the reinsurers joining together, the question of the ISO not wanting to go down a certain road and then being forced to go down a certain road by reason of the economic pressure of certain companies.

So I would say to you that as chairman of this subcommittee, I am very grateful to the Attorney General for the unbelievable amount of research that you had to put into this matter. I do indeed believe it was the responsibility of the Antitrust Division of the Department of Justice of this administration, but as is well understood, they are not particularly aggressive in enforcing the antitrust laws and those in charge totally contradict their own concept of the free enterprise system by refusing to enforce antitrust laws, which in my opinion is the underpinning of the entire free enterprise system.

Thank you.

Now let me ask you a couple of questions. The property/casualty industry likes to say there can't be any collusion since there are so many firms in the market. Is the industry wrong, and if so, help us to understand why.

Mr. **Shannon**. Well, they are wrong, Mr. Chairman, and of course, the Justice Department accepted that line. They said there were 3,500 carriers in the country, so there must be competition. The fact is, in particular lines and in particular geographic areas, there is not competition. There is one company or sometimes two companies which say they are competing, which don't really provide competition.

For instance, in my State a couple of years ago, we ran into a situation where there was no available day care coverage. There was no insurance coverage for day care centers. And it was only through the efforts of Governor Dukakis, who personally intervened and convinced an insurance company to begin writing that coverage again, that day care centers in Massachusetts were able to get liability insurance coverage.

It is a little bit like when this committee was looking at trucking deregulation a few years ago. There seemed to be a lot of trucking companies, but if you looked at particular routes and particular service, they weren't competing; and the insurance industry is the same kind of industry.

Senator **Metzenbaum**. Some suggestions has been made that these lawsuits were filed as part of an overall strategy to reverse political momentum in Congress to repeal the McCarran-Ferguson exemption. I think the industry has been somewhat adept in putting out that concept.

Is there any basis whatsoever to that?

Mr. **SHANNON**. Well, there is no basis at all, Senator. I'd like to see the McCarran-Ferguson exemption repealed, of course. But let me tell you, I speak for myself, and I am sure I speak for my colleagues—we have committed a lot of resources of our office to this litigation. We have investigated this industry for over 2 years. We have examined over 100,000 documents. We have interviewed or deposed 200 people in the insurance industry. We wouldn't have committed those resources, that time and that effort as some kind of legislative strategy, and we have no way of predicting what you and your colleagues are going to do. We did it because we think there are good and substantial claims here that we can prove in a court of law, and if we didn't feel we could make this case, whatever you do with McCarran-Ferguson, there is no way that any of us would have committed those kinds of resources.

Senator **METZENBAUM**. One last question, and then I'll turn it over to Senator Simon.

I might say, Senator Simon, I apologize to you; I didn't turn to you with respect to questions concerning Mr. Abrams. I do apologize.

Senator **SIMON**. I'll take advantage of the extra time to question both witnesses.

Senator **METZENBAUM**. Yes, please. Take as much as you want.

Let me just ask one more question, Mr. Shannon. Many see ISO, an organization controlled and funded by the industry, as a vehicle for collusion. Your statement describes how, on the very day reinsurers told ISO they wanted the forms changed to restrict coverage and limit defense costs, the ISO Executive Committee made the changes.

Do you agree that ISO was a focal point for collusion, and if so, what should be done about it; and if you know, how did ISO happen to come into being?

Mr. **SHANNON**. Well, first of all, Senator, I think the claims of our complaint indicate that ISO is a center for collusion as you describe it—a "choke point" as my colleague Mr. Abrams described it. It is a kind of a chasse guarde for the insurance industry. And that is why one of the things that we are looking for here is a restructuring of ISO, an opening up of ISO, a replacement of a majority of its Board of Directors with public interest representatives who aren't affiliated with the insurance industry, and an opening up of the data that ISO generates to the public. I think that that is perhaps the most important relief that we are looking for—in fact, I think, all the relief we are looking for is important in this litigation, but I think among the most important would be to make ISO publicly accountable, because in many, many respects they act like a public agency.

Senator **METZENBAUM**. Thank you very much.

Senator Simon.

Senator **SIMON**. Thank you, Mr. Chairman.

First, I want to comment the three of you, and my Attorney General in Illinois, Neil Hardigan, and the others, for initiating this action. It really is a public service.

And anemic as this administration is in the area of antitrust laws, they also say we have to modify McCarran-Ferguson. When you can get Howard Metzenbaum and the administration agreeing on the same course, let me tell you, you have an unusual set of circumstances.

The insurance industry today reminds me a little of the tobacco industry. Everybody else says cigarettes cause harm; the tobacco industry says there is no harm caused by cigarettes. The evidence is just overwhelming.

And to my friends in the insurance industry here, again, let me just repeat the message I have repeated over and over again here—you ought to be seeing to it that we have a modification of McCarran Ferguson.

But beyond that—and if I may include Attorney General Mattox in my question—just two questions. First, we are the only free nation that has insurance companies—or non-free nation—that doesn't have the regulation at the Federal level. I am not suggesting that we have it, although my experience in State Government is at one point, there was just no question that the insurance commissioner was regarded by all of us in State Government as being in the hip pocket of the insurance industry, and that was regarded as kind of the standard thing, nationally. I think things have improved since then.

But without suggesting that we should have Federal regulation, do you think it makes sense for the Commerce Department to gather information, to gather data, on the insurance industry? There is no other major industry with this kind of breadth of impact on the Nation where we don't gather information. If I may ask the question of all three of you.

Mr. **Abrams**. Senator, let me quickly say, absolutely. I think this has been one of the problems with respect to the insurance industry. There has been very little collection of data and information so that the spotlight of the public could be placed on really what happens within this industry, because all too often, there is an obfuscation of profits, money; there is some talk about reserves, but then there are charts and graphs indicating how many claims were made, how many payments were made in the course of the year, but without adequate review and investigation about all the investments that the insurance company makes and the kinds of profits that go in there.

So one of the things that I think has been sorely missing is an arsenal of information and data collection. Certainly, I would be one who would strongly welcome that eventuality.

Mr. **Shannon**. Senator, there are a lot of "red herrings" in this discussion of the insurance industry and McCarran-Ferguson and antitrust. One of them is the "red herring" that the industry keeps putting out that we are looking for Federal regulation of the insurance industry. Nobody is calling for Federal regulation of the insurance industry. And I know you have the insurance commissioners come before this committee and say stay out of this, leave McCarran-Ferguson alone; we are the ones who regulate.

The fact of the matter is State regulators don't have the resources to take on this multi-trillion dollar international industry with any kind of effectiveness.

There is a State Action Doctrine which exists and will continue to exist after the repeal of McCarran-Ferguson, which will in effect say in those areas where the States are regulating there will be no Federal antitrust enforcement. That is enough protection from over-regulation of the insurance industry. And I think it is very important that the Federal Government start collecting this data and making it available. If there isn't going to be some Federal scrutiny of the industry, at least collecting this data and making it available to those State regulators who want to do an aggressive job. So I would support that absolutely.

Mr. MATTOX. Senator, I am delighted by your question. My testimony has not been given yet, but part of that testimony would say that there are two principal recommendations that I intend to make, the first being the outright repeal of the McCarran-Ferguson Act. The second is to substitute for ISO—I think we ought to "ice" ISO, get rid of them entirely; I differ with my colleagues about restructuring it, and that is one of the reasons I filed a separate action in Texas—I think it should be done away with totally, and I think that the data-gathering function of ISO should be accepted by the Bureau of Economic Analysis with the Commerce Department or some other Federal agency.

I think it is very clear that we either need Federal data-gathering activity or some Federal regulation. I would prefer initially to allow the States to continue to regulate the insurance industry and attach it under the doctrines that initiated and brought about the McCarran-Ferguson Act, but I think there are some things that are extremely important that this committee should recognize. Just to give an example, the States are totally overpowered by the capability of ISO. There are more than twice as many actuaries working just for Aetna alone as for all the other States combined.

For instance, New York has 22 actuaries working for it. Texas, which has the second-largest department, has only four actuaries working for it. Aetna has 140 working for it.

If you look at the activities out there, you find that less than half of the insurance regulators in this country conduct financial examinations of their domicile companies one every 3 years. Four out of ten of our insurance regulators cannot retrieve statistical information on financial examinations. Only half of them can even compile complaints based on the companies that are involved. And only one-third have written procedures for even handling complaints.

And when you really look at what is happening out there, it is totally overpowering. In Texas, we are second-largest, and our State Board of Insurance has a budget of $44 million. Only $3.8 million of that goes toward regulating the property and casualty area. ISO has a budget of $140 million, just to give you some comparison, that goes toward compiling this data.

What we really need to do is have the Federal agencies substitute for the way it is being done now, and I think you'll get much better results, and I think the public clearly needs to have better representation, regardless of how this industry is restructured.

Senator **Simon**. One final question. Attorney General Abrams, in your testimony, you mentioned something that is a very, very tough thing to get hold of as you look at what we ought to be doing—some things are fairly clear, like modification or repeal of McCarran-Ferguson. But that is the whole question of the reinsurers, because you are dealing with, for example, Lloyd's of London.

Do you have any reflection on what we do about the problem of reinsurers?

Mr. **Abrams**. Yes. I think we have got to focus on them, initially, because they have been a rather invisible element of the insurance industry—go out and talk to even some of the most sophisticated people in this country about insurance, insurance companies, the insurance industry, and you mention reinsurance, retrocessional insurance—fog, glaze; they won't know what you are talking about. They don't realize that there are these entities out there, and they stand alone, unregulated, untouched, working with total freedom and abandon, producing the kind of inequitable circumstances that we have alleged in our lawsuit.

So I think again, we have got to take a close look at regulating the kind of activity that goes on, not just in terms of the primary insurance companies—and there are enough of those problems, as my friend Jim Mattox just pointed out—but now, looking at the secondary and tertiary level of that industry.

Senator **Metzenbaum**. You might define "retrocessional", because I turned to my staff member and said I didn't know that word.

Mr. **Abrams**. These are the reinsurers of the reinsurers. You have the primary insurance companies that give us all insurance, but those risks are too much for them to handle, so they go to a second level of insurance companies—buy off some of my risk—and they go to American reinsurance companies, they go to the syndicates and Lloyd's of London, and they buy pieces of that risk.

Now, those companies find that they need some protection, they need some insurance against the kinds of risk and peril that they just took obligation on, so they go to another level of insurance company, and it begins to pyramid that way, and you find that the second and third level escape regulation.

Senator **Metzenbaum**. Thank you.

Senator **Simon**. If I may follow through, can the State of New York regulate this second and third level, or how do we approach this thing?

Mr. **Abrams**. They do in a very marginal way.

Jim, do you want to respond?

Mr. **Mattox**. Mr. Chairman, Senator, I think that what you are hitting on is one of the most important aspects of what this committee ultimately should look at, this entire reinsurance area, because it is hard—you ask people in the insurance industry about reinsurance, and most of them have really only a vague understanding of what it is all about.

There is absolutely no reason why the most powerful nation on earth has got to have its largest market for reinsurance in Great Britain. There is no reason for it.

This committee and this Congress should move quickly to repeal McCarran-Ferguson, and move to assist the American insurance companies in an effort to restructure the reinsurance market of this world so that the United States would not have our dollars going abroad.

We are talking about all these trade problems, we start talking about OPEC—OPEC is not anything compared to the reinsurance industry that exists in this world. And the fact is that we States do not have the capability in reality to regulate the reinsurance carriers of this world; we don't have the capability.

When you really look at these things, you really see what the problem is. For instance, just to give an example, in a State when the members of the Bar have to get malpractice insurance, there may be two or three separate sources for the malpractice insurance. But each of those malpractice carriers will then have to get reinsurance, and the chances are they will get that from one specific company, and that one company controls all the rates.

Senator SIMON. If I may follow through, do we have any idea what kind of exodus of dollars we are talking about in reinsurance from this country?

Mr. MATTOX. I don't think we know. I think there are billions and billions of dollars. I honestly can't tell you. I have asked the same question, and I don't know the answer.

Senator SIMON. And if I may just add, this is what I find when I start asking questions in the insurance area; I end up with too many questions that nobody can answer. I think that somehow, we have got to get hold of this thing.

Mr. MATTOX. Senator, I think that this area of getting the information is one of the most important things that must be embarked on quickly, to get some understanding of that.

The fact is the insurance companies simply cannot operate without reinsurance. They have got to have reinsurance. It would be like lawyers not being able to have the threat of going to court. It is the same kind of capability. You have nothing if you don't have the capability to get reinsurance. That is the reason they are able to control this.

And the important thing, when we started looking at our information, we found there were only a very few—maybe two or three at most—people at Lloyd's of London who control the reinsurance industry of this entire world. We are not talking about collusion by a roomful of people; we are talking about only two or three who control the reinsurance industry of the entire world.

I just had one of my staff say that 40 percent of Lloyd's business, about $4 billion in premiums last year, comes from the United States, and the United States is the single-largest market for Lloyd's. Of course, we have some reinsurance carriers in Munich and places like that, but they also look so strongly toward Lloyd's that they have the capability to make decisions about that.

I think the problem is that there are so many different syndicates within Lloyd's, it is impossible to give anybody any accurate answers.

Mr. SHANNON. Senator, if I might, what we have here is a situation where a handful of people can have dinner in London, and the result of that dinner can be that a day care center in Rockford, Illinois isn't going to be able to get liability insurance coverage, or a softball program in Steubenville, Ohio isn't going to be able to get insurance. And that is literally—literally—what happened. They got together, they met, they walked away from the table, and we saw a crisis in this country as a result of that.

Now, why can't we get the answer? Well, the answer is simple: They are not regulated, period. Nobody regulates them. No government regulates them. The Federal Government has no insurance regulation. There is no antitrust enforcement. And they act like they are not regulated.

So I don't think anybody can provide those answers except the industry, and we are certainly going to try to get answers to some of those questions as we do further discovery in this litigation. I think we have begun to get some of those answers, but we need a change in the law if we are going to be able to begin to do the job that needs to be done here.

Senator SIMON. If I could just add—and I have exceeded my time here—but if any one of the three of you or your association upon reflection has some idea of what we can do or should do in this area of reinsurance, we'd be very pleased to hear from you.

Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you, Senator Simon.

I think we will ask the insurance representatives when they come forward to give us the facts as to how many dollars are being exported under the reinsurance arrangement. Absent our ability to obtain that from them, we will have the GAO do a study. Perhaps you and I might join in requesting them to do that.

But having said that, and before I call upon Mr. Mattox, I just want to say I have now had a chance to read this Letter of Intent. This is one of the most audacious documents I have ever read. This agreement to exclude certain kinds of coverage is absolutely beyond anything I have ever seen. And the worst part about it is that they did it right while we were discussing and working on the whole question of repealing the McCarran-Ferguson Act; and, although they are not subject to it, the fact is, it is an indication of how the American people are being ripped off—I guess all of these countries are English-based, is that right, Mr. Abrams?

Mr. ABRAMS. Right.

Senator METZENBAUM. And here is a combination saying that on a subject so vital and important as pollution and seepage, they are going to exclude it.

I think this is an absolutely incredible document.

Mr. ABRAMS. Open, blatant, notorious; it is right there, in black and white.

Senator METZENBAUM. And the interesting thing about is they didn't write 46 pages--they took two little paragraphs, and they said no way—no more coverage for those areas—and then all signed their names June 2, 1987. My staff advises me that was the date of the last McCarran-Ferguson hearing that we had. I guess they sort of said, "We'll show you"—I could use some stronger language, but it wouldn't be polite.

But to me, it is absolutely incredible. And what bothers me is that so many of those in the Congress who consider themselves advocates of the free enterprise system are not willing to join in taking away this exemption from the insurance industry because of its powerful lobby.

And I might say to each of you—Mr. Abrams, I know that Mr. D'Amato and Mr. Moynihan are not cosponsors of the bill; Mr. Shannon, Mr. Kennedy is, and Mr. Kerry isn't; and Mr. Mattox, we certainly would welcome Senator Bentsen and Senator Gramm.

I give each of you your special responsibilities, as well as the other 16 Attorneys General, to bring onboard some of the other Senators who are not yet cosponsors.

With all of that preliminary—I am very sorry, Senator Heflin. I didn't see you sitting down there. I thought you were part of the television crew.

Senator Heflin, please proceed.

Senator HEFLIN. Well, just put those cameras on me. [Laughter.]

Senator METZENBAUM. Senator Heflin, the reason the Democrats sit on this side is so that they will be on them. [Laughter.]

Senator HEFLIN. Well, I came in a while ago and listened to a portion of the testimony, and I have got other commitments, too; we have two or three hearings going on, and I am dividing time between them.

As I understand it, there are certain legal actions that have been filed under the antitrust provisions, and the McCarran-Ferguson Act, which allow for Federal suits for boycott, coercion and intimidation. It is my understanding that you as Attorneys General interpret the factual situations that have given rise to your lawsuits that come within the purview of either coercion, intimidation or boycott. Of course, that is for the courts to decide.

I assume in your interpretation that you feel that this gives you a broad range of activity in which you can bring action under the present McCarran-Ferguson antitrust provisions of the law; is that the position that you take in your lawsuit?

[Messrs. Abrams, Shannon and Mattox nod in the affirmative.]

Senator HEFLIN. So any boycott or any intimidation or any coercion which you feel your factual situations have given rise to, is adequate for your lawsuits to be able to survive—that is your position. That's all I have right now.

Senator METZENBAUM. Well, as a matter of fact, Senator Heflin, I believe there was testimony that the cases would be that much stronger if the McCarran-Ferguson Act were repealed. Aren't there some impediments to you resulting from the exemption?

Mr. MATTOX. Mr. Chairman, may I respond?

Senator METZENBAUM. Surely.

Mr. MATTOX. I appreciate our distinguished jurist asking the questions. I think you are going to find in our lawsuit, Senator, that the facts are not really in substantial dispute. I know the insurance industry is going to contest what really took place. But they operated so long under the McCarran-Ferguson Act exemptions that most of what they have done is pretty open. You have never seen an antitrust lawsuit like this before, because they felt that they were so protected under the umbrella of McCarran-Ferguson that they could do virtually everything that has taken place.

They have even told us: "We did it—so what?"

Now, the fact is that again, what has happened to the rates, what has happened to the boycotting of some of these lines of coverage, I don't think we are going to have a real dispute on. The question is whether or not their actions are protected under

McCarran-Ferguson or whether the prohibitions against boycott have an impact that we may be able to use as a foundation for our lawsuit. I think we can.

Senator **Metzenbaum**. I think the question that I understood the Senator asking was whether or not, since you are able to proceed presently on the boycott theory, is there any special reason why you need repeal of the McCarran-Ferguson Act?

Mr. **Shannon**. Sure. If I could address that, Mr. Chairman——

Senator **Heflin**. I didn't ask that, but that's a good question.

Mr. **Shannon**. Mr. Chairman, I testified here on this issue, I think, a year ago February, and you did ask that question at that time, and I told you, Senator, at that time that I felt that the threshold we had to overcome in order to bring an antitrust action against the insurance industry was such a high threshold that the industry felt that it was completely unregulated.

But I feel even more strongly now, after a year and a half of investigation of this industry, that it is essential that we repeal McCarran-Ferguson, because we went through a very careful process here of determining which claims we felt could withstand a McCarran-Ferguson attack, which is another way of saying that we found lots of collusive activity in the insurance industry that affected consumers that is not contained in this complaint and cannot be contained in this complaint because of McCarran-Ferguson.

So I think we can withstand the McCarran-Ferguson attack. It is going to be very interesting. We haven't gotten any answer from the industry yet. You know, their trade papers are now saying it is limited exemption, but I'm sure their answer will say it is sweeping, and this whole suit should be knocked out. But I feel very strongly, after reviewing all the documents, the investigation that we have done, that there is more collusive activity in this industry that needs to be attacked and cannot be attacked until McCarran-Ferguson is repealed.

Senator **Heflin**. How are your State laws? Do they give you any authority? Has your legislature given you as Attorney General adequate laws relative to the matter of antitrust suits in your State?

Mr. **Shannon**. Senator, if I can answer that question, frankly, if the world worked the way it should work, we shouldn't be in this suit at all. State attorneys general should be dealing with local kinds of antitrust matters. We had to get involved in this and other antitrust actions because of the absence of adequate—or frankly, of any—Federal antitrust enforcement in the last few years.

So I think in the best of all possible worlds, this kind of problem should be addressed by Federal laws and should be addressed by Federal antitrust enforcers, and it is not.

Mr. **Abrams**. And Senator, the power and the muscle of the insurance industry is such that it not only was capable some 40 years ago to get the Congress to vote special privilege and special exemption; it has been able to do that in various States across the country. So this has been a very powerful lobbying group. And I think if we see the Congress making steps in this regard, we will then perhaps see some action on the State level as well, so that we give no special umbrella of protection to this one, single industry.

Mr. **Mattox**. Senator, I might respond also that my lawsuit is a separate lawsuit; each of these lawsuits are separate, but the other States have theirs filed in Federal District Court in California, San Francisco. My lawsuit is filed in the State of Texas in the State court. The defendants are seeking to remove me to Federal court, and I am resisting that movement.

Our State antitrust law is relatively strong, as is our consumer protection law. We think we will be able to try this case in State court, and our theories are somewhat different than the theories that are being put forth by my colleagues. Our theories are directed more at the domestic carriers rather than the international reinsurance carriers, but the theories are similar in both ways. I have described it as we are covering both ends of the alley, so to speak, and the fact is that we don't want the reinsurance carriers to point their fingers at the domestic companies and say they did it, and then the domestic companies to point their fingers at the reinsurance carriers and say they did it.

So I am taking the domestic carriers, because I always like to have me a local-based company, and I am letting my colleagues take the international carriers—but we are each suing virtually, in many ways, the same carriers.

Senator **Heflin**. Do your long-arm statutes that presently exist for service take care of offshore reinsurance companies?

Mr. **Mattox**. They do, Senator, but you still have difficulty particularly with Lloyd's of London, because in Britain they do not have the same kind of antitrust laws that we have. They have virtually none, as a matter of fact. And the fact is that it is difficult to prevail against international carriers because they are treated nearly as quasi-governmental when they are as large as they are. As a matter of fact, in part of my testimony here, I was going to make a reference to one of the receptions that was held for the carriers, which happened to be on the Queen's yacht; it was only the tenth time in history that that yacht has been allowed to be occupied by outsiders.

Lloyd's works in a pretty much international foreign relations-type field, also, because of their capabilities, and they will quickly tell you that, too.

Senator **Heflin**. That's all. Thank you.

Senator **Metzenbaum**. Thank you, Senator Heflin.

Senator Hatch, we have heard from two witnesses, Mr. Abrams and Mr. Shannon. Mr. Mattox is our next witness.

Do you have an opening statement.

Senator **Hatch**. I will be happy to put it in the record, Mr. Chairman, if you will.

Senator **Metzenbaum**. Thank you very much. Without objection, the statement of Senator Hatch will be included in the record at the appropriate place.

We are happy to hear from you now, Mr. Mattox. Thank you for your patience and waiting. Please proceed.

Mr. **Mattox**. Mr. Chairman, I am delighted to be here, and I commend you for your great courage and leadership on this issue and your always outspoken attitude on representing the people, and my other colleagues here, I thank you for allowing me to testify today.

The lawsuits we have filed could be described as the defense lawyers' full employment suits of 1988 and beyond. We have done something for the defense law industry, I can assure you of this. I have never seen such an assortment and gathering of the major law firms at any time in my legal career, quite honestly. Employment, I think, is probably going down as a result of this.

I want to associate my testimony with that of my colleagues and adopt their testimony as mine, largely.

I would reiterate there are three basic things that I think need to take place, that this committee needs to do.

First, I think there needs to be an immediate outright repeal of McCarran-Ferguson.

The second thing is we need to replace the data-gathering function of ISO with the Bureau of Economic Analysis or some other agency within the Commerce Department or some other existing Federal agency.

The third thing I would recommend is an effort by this committee to try to determine how we can establish and bring about stronger American reinsurance companies so that our insurance dollars will not be going abroad as they are.

What I would ask this committee to do, though, is to use just plain, good, old common sense. I hate for the Senator from Alabama to have left, because I know he prides himself in that common sense approach. But you just think about this. Our lawsuit basically has sued eight carriers plus some reinsurance companies. They meet regularly, at least quarterly, and they sit around a big table in the ISO offices. They sit around there and talk about their profits, their losses, the kind of claims they are having, their experiences, the kinds of policies they will write. Now, you just put yourself in their positions and think about a little bit of the good larceny that takes place in the souls of all capitalists. And you can see that when you get around that table, it is pretty easy to decide that you are going to get you a bit more profits. And when I say "a bit," that's an understatement.

Let me explain to you basically, answering another couple of your questions, why it is so important to understand the lawsuit and the nature of it.

Basically, there are about 3,400 property and casualty insurance companies in this country—3,400-plus. About 1,300 of them are members of ISO. And these 1,300 write about 95 percent of all the insurance in this country. Now, in the troubling time period that we are concerned about, there were 37 separate companies that were members of the ISO Board of Directors, so to speak. They write 60 percent of all the insurance in this country.

Now, like all good organizations, of course, they have got an executive committee. The executive committee is made up of eight insurance companies. They are the ones who sit around the table. Now, there may be separate people on this committee, but it is basically the same eight companies, and they write 28 percent of all the insurance in this company.

Let me tell you, when they say you move, this industry moves. Let me tell you, when you hear the nonsense about they've got 3,400-3,500 companies in this industry, and they all talk—that's right. They have competition, but they have competition based on what these top companies say and what they do.

In 1984 and 1985, based on the documents that we've got, this industry decided they had too much competition, particularly in certain areas, and they started stopping it. And that is exactly what has happened with this and with the operation of the reinsurance market. They had a tremendous capability to have an impact.

Now, the question is whether or not you all are going to allow this to continue to happen. This Congress passed the McCarran-Ferguson Act in 1945, and it proposed certain limited exemptions. We have already talked about those exemptions, and we believe we can prove that those exemptions have been violated.

Let me just give you the example about how Texas got into this lawsuit initially. The small town of Westlake Hills, just outside Austin, Texas, wrote me a letter, saying they had been having some difficulty getting insurance. They said they had been incorporated since 1953, and only had one very small, minor claim, but had gone to 22 separate companies and could not get insurance from those companies, despite the fact that not 6 months earlier, those companies were all writing insurance. They couldn't get it. There wasn't any way to get it.

We started investigating, because any time 22 folks were there, and they are not there anymore, it makes a lawyer in the Antitrust Division pretty anxious. We looked, and we found, of course, that it was not happening just to that city, but it was happening to our counties, and it was happening to the opinionmakers in our society. It was happening to the boards of directors, it was happening to county governments, city governments, day care centers, to pastors—it was happening to people who had an impact on society out here.

So the State of Texas, the State of California, and some of my other colleagues decided we would go to look at this. And what we found, of course, is that there is an unbelievable amount of chumminess that exists within this industry. They meet regularly and in such frequent gathering places as Monte Carlo—they meet there at least every September—to talk about things. I have already told you about the Queen's yacht.

I might point out to you that when they were meeting on the Queen's yacht, there happened to be two State commissioners who were there with them at the time, to just talk about the chumminess.

But what they agreed to do basically, and we believe the documents in our case—and I'd say, Senator, the one that you saw, you ain't seen nothing yet, in the vernacular. The other documents that we aren't ready to reveal yet will show even as much if not more of a "smoking gun" as what we just showed you.

What we have found is that they conspired to drive up rates; they conspired to drive down coverage, based on the kind of policies that they were going to write, and they conspired to change the American civil justice system to meet their purposes and to accomplish their wills. And I must tell you this: They were largely successful in accomplishing each of those three goals in this country—largely successful.

I think that when they did that, of course, they brought a battalion of lobbyists into this Congress; they carried them across this United States; they were successful—and you are going to hear some testimony from a couple of them here in a few minutes, as a matter of fact, from the insurance industry. But they funded a multi-million dollar propaganda campaign that the idea was instead of marketing—and their literature clearly says this—they were going to change the idea of there being an insurance crisis to take the finger off of them, to saying that there was a lawsuit crisis and put the finger on the lawyers of this Nation of ours.

I am not saying the lawyers do not deserve some criticism, but I would tell you this. A false crisis was created, a crisis that was not justified based on the facts and based on the studies that we have done. But the thing we have found is that the insurance industry is so powerful today that when acting together, they can completely overwhelm the regulatory capabilities of the industry. Inadequate resources and small staffs make it impossible for the States to carry out their activities.

The ISO annual budget, I said a moment ago it was $140 million—I misquoted—it is $155 million. They have 2,700 employees, including 1,400 field offices. They operate in virtually every State. They have two offices in Texas, in Dallas and Austin. And I want to tell you, they virtually dominate the presentations that are made to all the State Boards of Insurance where the State Boards of Insurance want the presentations.

By and large what happens, as you have pointed out, Mr. Chairman, is they file their rates; they go into effect in most States—there are some States where there must be a hearing, and in Texas, I must tell you that those hearings are just totally overwhelmed by these particular individuals. The lobbyists themselves have even been quoted about the fact that these regulators have got no more idea of what is going on than the man in the moon, because the fact is they don't have adequate information.

And I must tell you this, too. While they were talking about the dire straits that they were in, we thought we'd take a look and see what was happening to them out there.

Let me just show you a couple things here that I think are interesting, and I don't want to belabor the point. We checked the Dow Jones stock average here, and found that the property and casualty stocks were basically, during the period of 1969 to 1985, doing three times better than the blue chips. Senators, those of you who believe clearly in the free enterprise system, the stock market was not showing us that this was an industry that was in dire straits.

And we said, maybe not after 1985—so we looked at their stock ratings here. This is the pattern of their stock ratings then. The Business Insurance Stock Index skyrocketed during the most recent trading period, setting a record high. Source: Business Insurance Magazine. Their own trade journal told us about that.

We thought we'd check a little bit closer and see what was happening to their profits nationally. This is again from their own national publications. Insurance Facts: National Underwriter told us that their profits from 1985 to 1987 went up from $2.1 billion to $13.7 billion, using their figures. I might point out to you that our figures would indicate that they actually went from about $2 billion to $23 billion in a 2-year period of time.

Mr. Chairman, I know my time has expired, and I'll be glad to answer any questions of this committee.

[Statement of Mr. Mattox follows:]

THE HONORABLE JIM MATTOX,
ATTORNEY GENERAL OF TEXAS,
TESTIFYING BEFORE THE SENATE JUDICIARY COMMITTEE,
SUBCOMMITTEE HEARING ON THE McCARRAN-FERGUSON ACT/STATE ANTITRUST ACTION AGAINST INSURANCE COMPANIES,
WASHINGTON, D.C.

June 14, 1988

Testimony by Jim Mattox, Senate Judiciary Committee, Washington, D.C., June 14, 1988

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

Mr. Chairman, I am delighted to be here with you. These hearings are extremely important because the insurance industry has engaged in blatant economic extortion of our citizens.

I would like to request that my full statement be submitted for the record.

My testimony will cover the specifics of our lawsuit, The State of Texas vs. Insurance Services Office, Inc. et al. And I will touch on other insurance reform related issues, with two specific recommendations.

My recommendations are:

1). Immediate and outright repeal of the McCarran-Ferguson Act.

2). Replacement of the data-gathering function of Insurance Services Office, or ISO, with the Bureau of Economic Analysis or another existing federal agency.

Mr. Chairman and members of the committee, let me show you why these two steps are so critical. I ask you to use common sense - pure, simple common sense. The leaders of the property and casualty insurance industry meet constantly to discuss their profits, their losses, and their objectives for the future.

They sit around the table in the board rooms of ISO in New York and they do what no other industry is allowed to do - by meeting together, talking together, planning together, strategizing together - and I might say, conspiring together. McCarran-Ferguson has given insurance companies far more comfort than regulation. It has allowed the industry to grow into one of the largest on earth, while conducting its business away from the glare of antitrust scrutiny.

ISO is best described as a pyramid. At the top, the eight corporate defendants represented on ISO's executive committee write 28% of all the property and casualty insurance in this country. The 37 companies that served on ISO's board of directors from 1982 to 1986 write approximately 60% of all the property and casualty insurance in this country. And the 1,400 companies that make up ISO's general membership write about 95% of all the property and casualty insurance in this country.

It doesn't take an expert to figure out what takes place when they meet together. They've even admitted it publically. And that's what our lawsuit is all about.

The question is, are we going to allow it to continue to happen?

The McCarran-Ferguson Act was signed into law on March 9, 1945. It granted the insurance industry a limited exemption from the antitrust laws that only applies to the business of insurance, to the extent regulated by state law. McCarran-Ferguson absolutely prohibits insurance companies from engaging in coercion, intimidation, or boycotts to accomplish their purposes.

It was the insurance industry's misperception of this grant of immunity, as well as their long operation under McCarran-Ferguson, that encouraged and emboldened it to engage in the illegal activities that are the subject of these lawsuits.

Attorneys general from eight states filed antitrust lawsuits against the leading companies of the property and casualty insurance industry and reinsurance carriers in federal court, while Texas filed its suit in state court. We expect other states to join the federal action.

Our lawsuit in Texas began as the result of a letter I received in September 1985 from the small town of West Lake Hills, just outside Austin. They told us that they had dealt with the same insurance company since incorporating as a city in 1953. They had filed one minor claim in all those years; yet they'd recently experienced a cancellation of their coverage. After being denied new coverage by 22 separate companies, they were asking for our help.

We also began hearing from others who could not get or could not afford insurance, even though they had little or no history of claims. The insurance industry had targeted the opinion makers of our society, from local governments to day-care centers, non-profit organizations to the clergy. The executive director of the Texas Easter Seal Society is with me today to testify about her organization's insurance dilemma.

My office conducted a two-and-a-half year investigation into the structure of the property and casualty insurance industry. In Texas alone, we examined over 60,000 documents and deposed more than 100 insurance professionals. We even traveled to London to investigate the syndicates of Lloyd's.

We found that the insurance industry was marked by constant communications and frequent gatherings of competitors - often in such exotic places as Monte Carlo. We found that the property and casualty insurance industry is controlled by the reinsurance carriers and the major companies that make up the executive committee and the board of directors of ISO. And we found that ISO, along with eight of the largest property and casualty insurers and several reinsurers, mounted a three-pronged attack on American consumers:

1). They conspired to drive up rates.
2). They conspired to drive down coverage.
3). They conspired to change the American civil justice system.

And, I might add, they were successful in accomplishing virtually all three of those objectives.

Our proof will show that the conspirators attempted to replace the existing policy with a more restrictive policy at a higher price. They intended to force it on consumers by boycotting the previous form, and on their competitors by controlling ISO services and the availability of reinsurance.

To achieve their goals, the conspirators sought to create a crisis atmosphere.

They sent a battalion of lobbyists all across the country - many of them right here in these halls. And they funded a multimillion propaganda campaign to market the idea that what existed was not an insurance crisis, but a crisis in our nation's civil justice system.

Although there is considerable overlap, our Texas lawsuit differs from the federal suits of the other states in at least one important aspect. The federal lawsuits are directed primarily at the conduct of the reinsurance carriers - which bankroll the industry - along with ISO. Our suit is directed primarily at the members of ISO and the effects of their conduct in Texas. But, taken together, the lawsuits effectively cover both ends of the alley so that they can't simply point fingers at each other, and say: "The other guys did it."

What we seek in our Texas lawsuit is a complete reform of the insurance industry - from top to bottom. We seek to remove the opportunities for collusion; and we seek both equitable restitution for consumers and civil penalties for the State.

The McCarran-Ferguson Act was originally passed under the concept of states' rights, to allow the state to continue to tax and regulate insurance companies within their borders. The industry will tell you that it is heavily regulated by the states. But the phrase "regulated by the state" contained in McCarran-Ferguson is far too vague. Such language fails to define the level of state action required to exempt insurance companies from federal and state antitrust laws.

As the Supreme Court noted in St. Paul Fire and Marine Insurance Co. v Barry, 438 U.S. 531, 549 (1978), the reason for making antitrust immunity dependent upon state regulation was to bring an end to the "system of private government which had been built up by a small group of insurance companies."

The fact is, the insurance industry is so powerful today that, when acting together, it completely overwhelms the regulatory capabilities of the states. The inadequate resources and small staffs of most state boards of insurance are mismatched against the massive resources of the insurance industry giants.

Let me give you an example of the mismatched resources. The State of Texas has the second highest-funded insurance board in the United States. It's budget this year is $44 million. But only $3.8 million of that amount is actually used to rate and regulate casualty insurance companies, and less than 6% of all insurance taxes collected nationwide go toward regulating the industry. When it comes to personnel, one of our defendants - Aetna - alone has twice as many actuaries as all 50 states combined.

By contrast, ISO's annual budget is $155 million. It has about 2,700 employees in 14 field offices, including Dallas and Austin, and operates in virtually every state of the Union.

The original purposes of ISO were to gather statistical data on past loss experiences so that its member companies can determine proper premiums, and to perform basic research on policy form issues. Unfortunately, this original purpose was corrupted by the members of ISO, who were encouraged by the limited exemption of McCarran-Ferguson to illegally coerce, intimidate, and boycott to accomplish their purposes.

When those big-time lobbyists came to you, claiming that they were in such dire financial straits, one of their own trade journals, Business Insurance magazine, reported that stock indexes had "skyrocketed... setting a record high."

Dire straits? This is the same industry that, in effect, paid no federal income taxes between 1975 and 1984 because it received net tax credits of $125 million, and even had net gains of over $75 billion during that period, according to the GAO.

Dire straits? This is the same industry whose property and casualty stocks performed three times better than the other blue chip stocks on the Dow Jones Average between 1969 and 1985.

Dire straits? This is the same industry whose profits nationwide grew by a rather dramatic 600 percent between 1985 and 1986 - just one year.

Dire straits? Last year, the chief executive officer of CIGNA was paid $1.2 million. The CEO at Aetna was paid over $1 million - a 31 percent increase in his salary over the year before, not even including that year's deferred compensation of $1.5 million. This man made $2.5 million last year.

I would like to point out to the committee that the theme of the propaganda campaign funded by the insurance industry was: "We All Pay the Price." We certainly do, we certainly do. They have extorted this price from us - American consumers and businesses alike - through their illegal, anti-competitive behavior. This is the most insidious fraud perpetrated on the American consumer in modern times - and it must never happen again.

This brings me back to my two recommendations.

1). The first is outright repeal of the McCarran-Ferguson Act. Quite frankly, McCarran-Ferguson does nothing more than encourage collusion. And there is absolutely no reason that the insurance industry should not be expected to do business under the same rules that apply to all other industries in this country.

2). After repealing McCarran-Ferguson, my second recommendation is to help the states improve their ability to regulate the industry by totally eliminating ISO from the process. Quite simply, we must ice ISO.

The legitimate work of gathering statistical data should then be assigned to an existing federal agency - perhaps the Bureau of Economic Analysis in the Commerce Department. Every insurance company should be required to supply basic information. And the agency's sole function should be limited to analyzing the data and providing statistics nationwide. The

states should retain full control over taxation and regulation of the insurance industry.

Mr. Chairman, we have a saying back in Texas: "No one ever got cut on the corners of a square deal." Clearly, the American people have not been getting a square deal from the insurance industry.

The work of this committee touches the lives of virtually every American consumer and business person. I urge you in the strongest possible terms to consider the recommendations I've offered here today. Together, we can help ensure that all insurance consumers finally get a square deal.

Thank you very much. I would be happy to answer questions from the Committee.

Senator **Metzenbaum**. Thank you very much for your testimony, and let me ask you a couple of questions.

At page 2 of your statement, you say, "It doesn't take an expert to figure out what takes place when they"—meaning ISO members—"meet together. They have even admitted it publicly. And that is what our lawsuit is all about."

What have they admitted publicly?

Mr. **Mattox**. Mr. Chairman, these documents, some of which have been submitted to the committee, are documents that were circulated relatively publicly. But the kind of clubby-type atmosphere that they operate in, this industry, the property and casualty industry, will have about 31 industry meetings just in June alone of this year to discuss what is taking place. They have annual joint meetings with the Insurance Information Institute; ISO and the American Insurance Association just happen to be at the same hotels and work at the same time. They have their annual reinsurance rendezvous in September in Monte Carlo. And they even meet annually, all the insurance executives, to discuss where they are going, down here at the Greenbrier Hotel, White Sulphur Springs, West Virginia—and I don't want to stop doing that, of course, because West Virginia needs the trade and business.

But after they have left those meetings, they have come up with some statements that are pretty remarkable, I must tell you. I can read you a couple of them, but just to give you an example: "The property and casualty insurance industry"—this comes from Lowell Beck, of the National Association of Independent Insurers—"is fighting for its survival and must forge new, wide alliances to win that fight. Our industry must be organized to deal with the issues. We need the active involvement of all company executives. You all throughout the country are invited to be in on the foray." That was talking about the program early on in 1983.

They go on down and continue to talk about this, and I'll just read you some of their statements.

"The Alliance itself," speaking of the Alliance of American Insurers, "is an institutional coalition founded on the tenet that our best allies are our competitors. It should be recognized in this context that there exists a paramount need for a continuous nucleus of interest to foster coalitions of diverse interests and circumstances as required."

I could go on and read you these statements. They are just replete. Let me give you just a couple more, because I think they are interesting.

The Insurance Information Institute says: "We are also seeing a significant increase in premiums, more restrictive terms and greater selectivity in the business, accepted by reinsurers both in the United States and London. Rising reinsurance rates ultimately bring similar actions by primary insurers."

Let me tell you, if you read the trade journals, and if you read the documents they put out, it's not difficult—"smoking guns"? You don't have to find "smoking guns"; you can find the bullets. You really can, because they are lying right out there, telling them to do it. Again, I just ask you to use common sense.

Any one of you in your business circles, if you get in there, and you are suffering a lot of competition, this industry does the exact same thing that every other industry has done—they either buy each other out, or they figure out a way to fix prices. That is what this industry has done.

And I might say to you that in engaging in the boycotts that they have engaged in, they have forced a significant portion of our primary coverage away from the admitted carriers in the marketplace over to our excess line carriers. Let me give you one statistic to give you an example.

In Texas, the excess line carriers increased in 1980, our figures show, from writing $208 million in insurance to just 6 years later, they were writing $689 million in excess line coverage.

The reason is if you deny coverage, like they did to my small city of Westlake Hills, if you deny coverage to them through the admitted lines where you have insurance regulation, they can move very easily to the non-admitted lines, the excess coverage, and charge whatever the market will bear. And let me tell you, they have most certainly done it. They have engaged in economic extortion of the American people, the most insidious consumer problem that has taken place in modern times.

Senator **Metzenbaum**. Mr. Mattox, the insurance industry is a major factor in the free enterprise system. Do you feel that their conduct is in accord with the accepted concept of free competition in the free enterprise system?

Mr. **Mattox**. I don't know how it could be, Senator. They are the only ones who have got this kind of exemption, operating through ISO and these other trade organizations. I can't understand how anybody in good conscience who believes in the free enterprise system and believes in competition can continue to be in favor of this Act that was passed in 1945. I do not think it was ever intended to give this kind of protection that is given.

When the McCarran-Ferguson Act was passed, it was with the concept of having adequate State regulation, and as a minimum, if nothing else, this committee ought to amend the Act to describe what is really meant by that kind of adequate regulation, because we simply don't have it today.

Senator **Metzenbaum**. Thank you.

Senator Hatch?

Senator **Hatch**. Thank you, Mr. Chairman.

Let me ask all three of you, it is my understanding that the States attorneys general have filed an action alleging collusive conduct and intimidation on the part of the insurance industry under the Federal antitrust laws. Now, is it not also true that most States have antitrust laws which permit the State Attorney General to challenge alleged anticompetitive activity within the State's borders? Am I wrong? Do all three of your States have that type of a law?

Mr. **Abrams**. Yes.

Senator **Hatch**. Texas does not?

Mr. **Mattox**. Senator, what I would say is that most States have laws that——

Senator **Hatch**. First, let me just ask if you have them. You are "No"? Texas does not have that type of a law?

Mr. **Mattox**. I must answer your question without saying yes or no.

Senator HATCH. Okay, let me get back to you, then.

You have it, Mr. Shannon?

Mr. SHANNON. Yes, we have a law.

Senator HATCH. Mr. Abrams, do you have it?

Mr. ABRAMS. We have a law.

Senator HATCH. I am fully aware you do. I thought Texas did, too. Let me just ask the latter question. If that is so, why in the world can't you do what you want to do under the State law? Why do you have to come to the Federal Government and say repeal an exemption that has really, I think, meant a lot to competition in the insurance business over all these years and has kept State control over the insurance industry, which it seems to me is better than Federal control.

Why is it not sufficient protection against anticompetitive activities in insurance companies—which I am sure occasionally exists and arises. But you say Texas does not have that kind of a law?

Mr. MATTOX. No, that's not what I said, Senator——

Senator HATCH. Okay, you said you couldn't say yes or no.

Mr. MATTOX. You let me respond, and I'll be glad to tell you.

Senator HATCH. I'm going to let you respond.

Mr. MATTOX. The simple fact is that nearly all States have laws that are antitrust laws, but they provide exemptions. They in effect say that you may take action under the State law except to the extent that the Federal law offers a preemption. The Federal law offers a preemption in this particular circumstance. The preemption is the McCarran-Ferguson Act that in effect says the insurance companies are exempted from antitrust restrictions even under State law, except if they engage in boycott, coercion or intimidation. And our lawsuits are founded on that particular exemption under the Federal law.

Senator HATCH. All right. We have heard that antitrust exemptions, namely, the McCarran-Ferguson Act, insulate insurance companies from suits based on collusive activities. Yet in fact, the major lawsuit featured in this hearing, it seems to me, is evidence that the insurance companies can be and are sued under antitrust, which is what you are doing.

But one other point. The insurance industry is comprised of nearly 3,500 companies, none of which holds more than 8 percent of the market. Now, it is hard for me to imagine a more competitive atmosphere, and I might say it is hard to imagine how ISO, or eight of the 3,500 companies, or any other subgroup you want to mention of these companies, can control all of the others. Plus, consider the fact that you have insurance commissioners in all 50 of the States, scrutinizing everything that goes on with insurance companies, looking for abuses; plus, as we have, I think, seen, and you have pointed out, antitrust suits can be brought on the basis of allegations of boycott.

You know, if anyone fears the 3,500 are colluding unfairly, they can bring antitrust action on that basis alone.

So what bothers me is why come in and ask for the Federal exemption to be taken away? Some of you have noted that the States should be able to regulate the insurance industry. How does repeal of the McCarran-Ferguson Act exemption allow the States to regulate the industry better? It seems to me your arguments are somewhat inconsistent—although I think if there is anticompetitive conduct—and I am sure that may exist from time to time—if there is anticompetitive conduct, it ought to be stamped out, no question about it; we agree with you. But can't you do it under existing law, under existing State power, rather than go to Federal court, where admittedly there may be more publicity, there may be more interest, but it seems to me you can do it just as easily, if not better, in the State courts, because people are going to be outraged where there are in fact antitrust violations or anticompetitive violations or boycott violations which may be part of both.

Mr. ABRAMS. Senator Hatch, before you came in, I think it was pointed out that the same powerful lobbying force that in 1945 convinced the Congress to create an exemption, a rather unique exemption in the antitrust laws for this industry, has operated in the States. So in many States, you have inhibitions and barriers that have been erected——

Senator HATCH. That doesn't stop you from bringing lawsuits pursuant to your own law, to give you every right to do it that you'd have in Federal law, only pursuant to State law. I mean, why come in here and say, "We've got to bring these in Federal court"?

Senator METZENBAUM. Won't you let him answer, Senator?

Senator HATCH. I will.

Mr. ABRAMS. There are similar kinds of barriers found in many States that exist in the Federal jurisdiction under McCarran-Ferguson, and I guess——

Senator HATCH. But they don't exist in New York.

Mr. ABRAMS. There are strictures. We don't have a totally——

Senator HATCH. Not much, not much.

Mr. ABRAMS. There are strictures. One of the things that we do in New York very often—and all my colleagues do—we have an opportunity to bring cases either under State law or Federal law. And most of the cases that we bring are under Federal law. We seek to invoke Federal provisions.

Senator HATCH. I am aware of that. But that doesn't mean it is better than under State law.

Mr. ABRAMS. But independent of these lawsuits, what we are saying is why the insurance industry having this special exemption——

Senator HATCH. Why not?

Mr. ABRAMS. Why not the automobile industry?

Senator HATCH. Why not, because if you take the exemption away, you get the Federal Government starting to tell insurance companies all over the country what they can and cannot do. I know that you have a suspicion of the capitalist system, as you have indicated, but it seems to me that system has worked pretty well.

Mr. ABRAMS. No—I always talk about the free enterprise system and the capitalist system, being a supporter of that, and——

Senator HATCH. Oh, I know you are.

Mr. ABRAMS [continuing]. And the antitrust laws——

Senator HATCH. I was referring to Mr. Mattox and his comments.

Mr. ABRAMS. But the antitrust laws, I always say, are the Magna Carta for the free enterprise system in this country. They have been——

Senator **Hatch**. I don't disagree.

Mr. **Abrams**. They have been a bipartisan effort. Senator Sherman was a Republican from the great State of Ohio, and the Congress has not viewed the antitrust——

Senator **Hatch**. Those are Republican laws, and I think they ought to be enforced, and I find some criticism with this present Justice Department that it is not more aggressive in enforcing the antitrust laws of this country—although I find an equal fault on the part of some prior Justice Departments who were too aggressive.

So the point is that we need some balance in these things. But what I'm having trouble with is I happen to know that New York has very wide-open laws, State laws, that would allow you to do everything that you are complaining about here today, so why come here and say only the Federal Government can do it, unless bringing lawsuits in the Federal courts happens to be better—and you and I both know it isn't better.

Mr. **Abrams**. No, we're not saying that, Senator.

Senator **Hatch**. It's more publicity, I do know that.

Mr. **Abrams**. No. You are putting words in our mouths. What we are saying is that the insurance industry is treated sui generis. It is treated differently from almost any other industry—the industry that manufactures microphones, the industry that manufactures pens, the industry that manufactures glasses, automobiles, whatever—why do we give this special, sacrosanct treatment to this insurance industry? And I think the time has come for us to face that question and to answer it in a definitive way.

Senator **Hatch**. Well, then, let me answer it for you. I think the reason that we don't is because we don't want the 3,500 insurance companies all over this country dominated by Federal law. We want to have the States who have individual needs and resources and problems to be able to solve those through their own insurance commissioners and their own attorneys general, and almost every State, I believe, including Texas, basically, provides the right to bring State actions for anticompetitive conduct—and certainly, boycott.

So it seems inconsistent to me that States' attorneys general have more confidence in the Federal courts than they do in their own State courts. And if that is so, then maybe the people in the States ought to start looking at what kind of judges they are putting on those benches, or look at the system.

Name me one other industry with 3,500 competitors with none having more than 8 percent of the market. I don't think you can.

Senator **Metzenbaum**. Mr. Shannon has been trying to respond for quite a while.

Senator **Hatch**. I have been chatting with Mr. Abrams. I'll be happy to turn to Mr. Shannon.

Mr. **Shannon**. Senator, if I can, we did cover some of this ground earlier, but I think the point is important. First of all, nobody is saying we want Federal regulation of the insurance——

Senator **Hatch**. But that is what is going to happen.

Mr. **Shannon**. No, that is not what is going to happen. To the degree that we have a State Action Doctrine, you are not going to have Federal regulation. Nobody is trying to usurp the role of the insurance commissioners or the States in those areas where they in fact regulate. And I think we have got to make that perfectly clear here.

Now, the reason we need a repeal of the McCarran-Ferguson exemption is the fact that—and you are right, you are absolutely right; most States have antitrust laws. We use them very vigorously in Massachusetts, and I think the other States as well. They are most effective when we are dealing with local problems. They are not as effective when we are dealing with national or multinational industries.

Senator **METZENBAUM**. Or international.

Mr. **SHANNON**. International companies.

This is a very unusual——

Senator **HATCH**. Why not?

Mr. **SHANNON** [continuing]. This is a very unusual suit, and we would not have brought this suit if we hadn't had a real crisis in this country in liability insurance. It is frankly not the kind litigation in which we want to be involved, or should we be involved. If we had a more aggressive Federal antitrust enforcement, with the appropriate laws, State attorneys general wouldn't be involved in this litigation. And I hope we are going to see both of those things come to pass.

Senator **HATCH**. And Mr. Shannon, that makes my point. Nothing has stopped you from bringing this particular litigation based upon present law.

Mr. **SHANNON**. Let me answer that, Senator. Senator Heflin asked the same question. As I pointed out to him, we brought the charges in our complaint that we thought could withstand the McCarran-Ferguson defense. That is not to say that all the collusive activity that we found in the insurance industry which harmed consumers is in this complaint. We have to knock out what otherwise, I think, would have been substantial and important charges because of McCarran-Ferguson.

Senator **HATCH**. And had you done it in the State courts, you wouldn't have had to have knocked them out. Now, I agree; you are saying that——

Mr. **MATTOX**. That's totally wrong, sir. That's totally wrong.

Senator **HATCH**. I don't agree. Let me ask you this.

Senator **METZENBAUM**. Don't you want to let him finish?

Mr. **MATTOX**. My action is filed in State court, Senator, for your——

Senator **HATCH**. Why don't you let me ask the questions, and I'll try not to interrupt. This is clearly give and take here. I'm not trying to be rude to our friends here from the States. But let's be honest about it. It is one thing to come in here and say that the capitalist system is greedy, and people are just out there to gouge all the consumers of America. That is what we call good "populace bullcrap". And to be honest with you, that doesn't mean that it doesn't exist, either. But let's at least be responsible about it. And I haven't noticed you two doing that, so I'm not finding fault with the two of you. I am finding fault with Mr. Mattox.

In all honesty, I don't see the "smoking gun" here in this letter of intent. Maybe you'll have to point it out to me. Maybe I'm too stupid to point it out. But the fact of the matter is that I think you are going to find that in insurance industries, the reason for the difference is that the insurance industry has to price its products on the basis of predictions of the future—it has to—not on the idea of surety. No other product in society is really the same. And therefore, it seems to me insurance companies have to share information in order to make good predictions in the public interest.

Now, we can all find fault, it seems to me, maybe with the way they make some of the predictions, and that's fair game. But you cannot run that industry without good actuarial work and predictions. And sometimes the predictions are wrong. In that regard, let me just——

Senator METZENBAUM. Our bill does not provide any barrier to sharing of information.

Senator HATCH. I understand that.

Senator METZENBAUM. We have no problem with that, so now you can sign on.

Senator HATCH. I understand that. Well, this is sharing of information.

Senator METZENBAUM. Sharing of information—that document? That document is no sharing of information. That document is an agreement we will not sell any insurance, provide any reinsurance, with respect to——

Senator HATCH. It includes a seepage and pollution exclusion clause, unless they have an original——

Senator METZENBAUM. We are going to agree there will be no seepage and pollution coverage, period.

Senator HATCH. That's right. That's what they're saying.

Senator METZENBAUM. And you don't think that that affected the people of Utah? You don't think that affected the people of Texas and Massachusetts and New York and Ohio?

Senator HATCH. You're saying that's an antitrust violation. You're saying that's a "smoking gun."

Senator METZENBAUM. I am saying worse than an antitrust violation. I'm saying that's as un-American as you could possibly be.

Senator HATCH. Oh, I see.

Senator METZENBAUM. That's an un-American kind of document.

Senator HATCH. Well, that's also good populace bullcorn, too.

Senator METZENBAUM. Well, I want to tell you something. You may call it populace bullcrap, but stay with the facts. You are talking about our being dominated by Federal law—nothing in my bill provides for domination by Federal law. Nothing in my bill provides for Federal regulation.

You are building up a mirage, and then you want to knock the mirage down. All we are saying is free competition is free enterprise.

Senator HATCH. And all I'm saying is you've got it today, and you've got it under——

Senator METZENBAUM. Look at his charts.

Senator HATCH. You've got a right to check uncompetitive conduct under State laws, and don't tell me you don't—and these people know it. And now you want to come to the Federal Government and say we want to bring massive lawsuits in Federal court——

Senator **Metzenbaum**. We want your friends in the insurance industry to play by the same rules everybody else in America plays by—the auto industry, the steel industry, the electric industry.

Senator **Hatch**. Actually, they are more competitive than those other industries. In the auto industry, you know there are only a few companies, and in this industry, there are 3,500 companies—3,500, totally regulated by 50 State commissioners and State legislatures.

Senator **Metzenbaum**. Those 50 State commissioners in the main don't do a thing; they go on vacations with the insurance industry, and they get royally treated by them. They have been doing that for years. I was in the State legislature when they passed this legislation in Ohio. It came about from the insurance industry. They wanted to have a mirage, a bill that pretended it was going to regulate, but didn't really regulate. Let's not kid ourselves. The insurance industry didn't go from $2 billion in profits to $23 billion, as Mr. Mattox has pointed out, or $15 billion, to take the insurance industry's own figures, without there being this conspiracy to cut back on the coverage and increase the rates.

Senator **Hatch**. Well, Howard, that's a pretty outrageous statement. Let me just say this, please—I knew I could get a rise out of Howard here today, and true to form, I want you to know that he is a very aggressive, very, very intelligent and effective Senator—wrong most of the time. [Laughter.]

Nevertheless, sincerely wrong; I just want to say that.

But let me just say this. If there is anticompetitive conduct, then it ought to be stamped out, it really ought to, and we ought to use the State antitrust laws to do that.

If there is gouging of the consumers, that ought to be knocked out, and you can use the State laws to do that.

I think one reason they came up with the McCarran-Ferguson exemption, among other reasons, and the whole McCarran-Ferguson Act, is because this is a unique industry. To compare it with the automobile industry, which is dominated by three companies—some say two—I think is not a very good comparison.

My time is up, I have been told, but let me put into the record a monograph called, "Insurance Antitrust Litigation: The Conspiracy Theory and Related Policy Issues". This is printed by the Insurance Information Institute, but I find it to be doggone valid and I think a good explanation.

And I just want to say this. I understand you State attorneys general, and I respect you, and I expect you to do it in the best possible way. But I think you have the tools to do it with, and I don't think we have to gum up this industry necessarily by repealing the exemption, but I'll keep an open mind and look at it. It just seems to me you are going to have to make an overwhelming case if it should be repealed.

But thank you, Mr. Chairman. I appreciate it.

Senator **Metzenbaum**. Senator Hatch, I appreciate your wanting to put that into the record, but I sort of wonder, since it is an article sort of arguing the basic issue in this matter, whether, if we start to take an argument on one side, and we take one on the other, do we just fill up the record——

Senator **Hatch**. I don't care if somebody else puts anything in; I just want that in the record at this point, because I think it makes my case. And if we'd like to summarize it, that would be all right, too. I just think it would be good to have in the record if we're going to make the record complete.

Senator **Metzenbaum**. You've got a lot of notes on the back.

Senator **Hatch**. We'll take the notes off; we'll give you a clean copy.

Senator **Metzenbaum**. Without objection, I will include a summary of that in the record.

Senator **Hatch**. Sure—well, should we put the whole thing in? Let's just put the whole thing in, because this is an important enough hearing.

Senator **Metzenbaum**. All right. At the conclusion of the testimony, we will put that into the record without objection.

Senator **Hatch**. Well, no. I'd like it right here, where I'm making these points so that people who read the record, if they do—and I'll be shocked if they will—can at least see these particular arguments in the record.

Senator **Metzenbaum**. Well, this may confuse them more than your original testimony, but we'll include it in the record.

Senator **Hatch**. Thank you. That's very possible.

[Document follows:]

Insurance Antitrust Litigation:

The Conspiracy Theory and Related Policy Issues

iii

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Introduction

The lawsuits filed recently by nine state attorneys general alleging antitrust violations in the insurance industry raise public policy issues of significant concern to consumers.

Each of the companies and organizations named in the suit has vigorously denied the charges. Senior insurance executives have expressed dismay that the lawsuits call into question the integrity of companies and industry organizations that have served the public well while operating scrupulously within the letter and spirit of the laws and regulations governing the business of insurance in the fifty states.

As part of the Insurance Information Institute's continuing commitment to examine all issues pertinent to the role of property/casualty insurance in serving American consumers, we have prepared this paper. It contains an analysis of the major issues confronted in the lawsuits and the underlying policy debate which they reflect. The paper explores the conspiracy theory and industry profitability, insurance regulation under existing law, the impact of the tort system on claims costs for insured and uninsured entities along with other related issues. We believe it will provide a useful perspective for those who wish to know more about the complex issues raised in the lawsuits.

For assistance in preparing this document, we acknowledge with thanks our Special Counsel William E. Bailey; Orin Kramer, Consultant; and I.I.I. staff members, Charles C. Clarke, Executive Vice President; Sean F. Mooney, Ph.D., CPCU, Senior Vice President and Economist; and Warren Levy, Vice President.

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Mechlin D. Moore
President

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Insurance Antitrust Litigation:

The Conspiracy Theory and Related Policy Issues

Two years ago, a group of state attorneys general initiated a multistate investigation into the 1984-1986 liability insurance crisis. On March 22, 1988, that investigation culminated in the highly publicized filing of lawsuits charging antitrust violations by eight state attorneys general (Alabama, California, Massachusetts, Minnesota, New York, Texas, West Virginia, and Wisconsin). Subsequently, the attorney general of Arizona filed a similar complaint, and other states are considering joining the litigation.

The eight federal antitrust actions (the Texas action was filed in state court) charged four major domestic insurance companies, two trade associations, and various domestic and foreign reinsurers, reinsurance brokers, and officers of those organizations with manipulating the market for commercial liability insurance. The litigation, which charged 31 defendants, is viewed as one of the largest antitrust actions ever filed by state attorneys general.

The lawsuits allege that the insurers intimidated the Insurance Services Office, Inc., a New York-based rate-making organization, into narrowing the coverage under its widely used standard commercial liability policy.

The attorneys general charge that the conspirators unlawfully exercised their market power to guarantee that no competitors could offer broader coverage than the reduced insurance they were supporting. They have often alleged in their public comments that this improper narrowing of coverage caused the liability insurance crisis of 1984-86.

Various defendants have vigorously denied any wrongdoing and have challenged the facts, legal interpretations and economic theories advanced by the plaintiffs. Antitrust experts have been quoted in news articles expressing doubts that the legal theory underlying the litigation is appropriate and questioning its probabilities of success. The purpose of this paper, however, is not to address the accuracy or legal sufficiency of the allegations, which can only be determined by the courts in the years ahead. The purpose here is to address the immediate public policy issues raised by this litigation.

I. The Underlying Policy Debate

From a long-term perspective, the recently filed litigation can most appropriately be viewed as the latest skirmish in an ongoing battle over the causes of the recent liability crisis and the behavior of the civil justice system. According to one school, the liability crisis was primarily caused by rising court awards and the expansion of tort law liability. That reading of the crisis, endorsed by broad-based coalitions, governmental commissions, and academics, produced strong legislative momentum behind various tort reforms.

Those who have aggressively fought those reforms—including several of the attorneys general—have tended to deny the existence of serious problems within the civil justice system and to ascribe the recent crisis to some sort of conspiracy among insurers. Whether the conspiracy thesis represents a good-faith explanation for a complex crisis or can better be viewed as a tactical maneuver to derail tort reform, the conspiracy thesis matters. It matters not simply because of its implications for tort reform, but because the natural byproduct of the thesis is a policy agenda aimed at a radical restructuring of the insurance regulatory framework. In essence, the argument has been that insurers engage in conspiracies because the industry's antitrust status—while explicitly prohibiting boycott, coercion, and intimidation—is so permissive that it is conducive to conspiracy. The *irony* is that the one thing this antitrust litigation *does* demonstrate is that, critics' charges notwithstanding, the industry *is* subject to antitrust laws.

Consequently, the *filing* of this antitrust litigation matters because it has been used by proponents of the conspiracy thesis—again, including some of the plaintiffs—as a visible platform for validating that thesis and reinforcing the case for their broader public policy agenda. Indeed, amidst the flamboyant rhetoric that characterized some of the press conferences scheduled across the country subsequent to the filing of this litigation, several of the plaintiffs were quite candid in setting forth their real political goals.

Refocusing attention on the documented causes of the liability crisis would serve the public interest; difficult issues involving the structure of the tort system still remain to be addressed, and a deeper understanding of the workings of the insurance mechanism would enhance the public policy dialogue. But the effort to use this antitrust litigation—which, even if it *were* legally meritorious, focuses on a narrow segment of the insurance marketplace—as a springboard to support the discredited theory that the liability crisis resulted from insurer conspiracy, can only set back the public debate. The real risks posed by the recent lawsuits are that much of what analysts have learned about the root causes of the liability crisis will be unlearned, public understanding of the workings of the insurance mechanism will be undermined, and hard decisions regarding the tort system will be deferred.

II. Conspiracy Rhetoric vs. The Litigation

Allegations in the lawsuits fail to support the theory that insurer conspiracy caused the liability crisis. Indeed, some of the attorneys general's oral statements about the lawsuits notwithstanding, the federal lawsuits themselves fail even to make that broad allegation. The furthest the fact sheet distributed by the attorneys general goes is to assert that the purported conspiracies "were an important contributing factor" to the crisis.

The lawsuits charge the defendants with colluding to narrow the coverage of the standard commercial general liability policy and exercising their market power to prevent competitors from offering broader coverage. Specifically, the defendants are said to have colluded to force adoption of a "claims-made" form as a substitute for the widely-used "occurrence" form, and to exclude pollution liability coverage as a component of the standard commercial general liability form. Under the claims-made policy, coverage is provided for claims filed during the year the policy was written. Under the occurrence form, the policy covers events occurring during the year the policy was written, even if the injury did not manifest itself and the claim was not filed until years after the policy period ended.

The allegations fail to support the conspiracy thesis as a central cause of the crisis for four fundamental reasons. First, the new policy forms are used in a narrow slice of the insurance marketplace, whereas the crisis cut across American life, affecting broad classes of insureds. Less than 5% of all general liability coverage written today is under claims-made policies. If a plot existed, it demonstrably failed, which in itself should suffice to scuttle the notion that the crisis was a product of conspiracy.

Second, the policy form conspiracy fails to square with the basic characteristics of the liability crisis. The most prominent characteristic of the liability crisis was that rates surged for many insureds. There is nothing in the alleged conspiracy in the federal suits that relates to pricing; a conspiracy to develop new policy forms can hardly explain a crisis of rising rates. A secondary characteristic of the recent crisis was that some insureds were unable to buy any coverage at *any* cost; again, the allegations fail to explain this phenomenon.

Third, there is the perplexing timing question. The claims-made form was the purported instrument of the crisis, yet although the crisis began in 1984, most state regulators failed to approve the new form before 1986. Related to the timing issue is the geographic issue. Three states involved in the lawsuits, California, Massachusetts and Texas, never approved key provisions of the claims-made form for general use.

Finally, the allegations fail as an explanation of the crisis because the claims-made form was an effort to *enhance*, not restrict, the insurance products available to consumers. Claims-made forms were designed and today serve as an alternative to, not a substitute for, occurrence forms. For most risks, where claims tend to be filed within a reasonably short period after the injury or loss occurred, the occurrence policy is suitable both for insurers and insureds, and it continues to be purchased. But in the so-called long-tail lines, such as products liability, where claims are often filed years or decades after the harm occurred, expanding liability laws have exposed insurers to liability which could never have been anticipated and for which premiums were never paid. Faced with open-ended financial exposure and a total loss of predictability, insurers individually began to reduce their coverage of long-tail risks. The claims-made form was a response designed to *increase* the availability of coverage to those long-tail risks. Insurers *want* to sell insurance; it is how thay make money. The unavailability of a suitable product for certain classes of long-term risks not only left those risks without needed coverage, it constituted an economic loss for insurers; the claims-made policy resolved that problem. (For a fuller discussion of the pollution liability problem and the evolution of the claims-made form and the public policy benefits which led insurance regulators to approve its use, see Appendix.)

The new policy forms not only represented a response to market realities, but they were also developed in full public view. Every argument for and against claims-made policies was made in public forums—before regulators and state commissions, at industry meetings, and at other public meetings. The process of developing new policy language included, as it always has, all segments of the insurance industry, consumers, regulators, agents and brokers. The widest range of interest groups testified at public hearings about the advantages, disadvantages, and applicability of the new policy language. Ultimately, *no* policy language was ever put into use except after regulatory approval subsequent to completion of the statutorily mandated review process. Proponents of the conspiracy thesis may not *like* particular policy language or the process by which they were developed, but the assertion that the forms were unilaterally imposed by the industry on the public ignores both the political and legal realities of the regulatory approval process.

Since the role of the reinsurer defendants in the alleged conspiracy is different from that of the primary writers (the companies that sell policies to insureds), the role of reinsurers in the liability crisis deserves separate treatment. Essentially, the charge against the reinsurers is that by refusing to provide reinsurance for certain classes of risks unless certain provisions were inserted in policy forms, they provided the clout to assure that the proposed new policy form language was adopted. In fact, many reinsurers *did* want new policy language and showed no hesitation about expressing those views publicly, but it is unnecessary to reach for some conspiracy theory to understand the forces driving their concern.

The availability of reinsurance—insurance for insurance companies—is vital to the proper functioning of the insurance marketplace. Basically, in return for some portion of the premium paid by insureds, reinsurers enter into contracts with primary writers to pay claims that rise above some specified level. Even for the largest insurance companies, the availability of reinsurance plays a crucial role in determining how much policy coverage is written. While most reinsurance in this country is provided by U.S.-based firms, foreign reinsurers also play a major role in the U.S. market and are a major source of capital for this nation's insurance marketplace.

In the late 1970's, the reinsurance industry was in strong financial condition, and reinsurance was readily available. In particular, an enormous amount of reinsurance swept into the long-tail lines, including risks relating to the handling of toxic substances. But the tort law revolution that produced spiralling claim costs (see Section VI) for primary writers had a particularly devastating impact on reinsurers. Prior to 1983, combined ratios (the standard analytic measure of the financial health of underwriting activity) for reinsurers roughly tracked those of primary insurers. But as claim costs rose sharply in the 1980's, losses for reinsurers mounted. To the degree that the surge in liability costs and liability doctrine imposed an unforeseen cost burden on insurers, the impact fell disproportionately on reinsurers. By 1984, combined ratios for U.S. reinsurers were substantially worse than for U.S. primary insurers, and reinsurers were registering a negative return on equity. While reinsurance has historically been a cyclical industry, the recent downturn was unprecedented in previous cycles.

Reinsurers responded predictably to that financial hemorrhaging by reducing coverage, and by insisting on coverage terms that would protect them against a recurrence of their recent devastating losses. Reinsurance companies are major financial entities in their own right; there is no rational reason for them to permit their views to be "orchestrated" by primary insurers, as the attorneys general allege. Their views on policy language, enunciated frequently in public forums, simply reflected the determinations of individual reinsurers with respect to the conditions under which reinsurance could be provided in a dramatically changing tort law environment.

III. Theoretical and Empirical Evidence on the Conspiracy Issue

As a staple feature in the liability debate, the insurer conspiracy crisis has been extensively researched by the United States Department of Justice, various independent state commissions, and numerous academics. They have uniformly rejected the conspiracy thesis as a plausible explanation of the crisis.

Excerpts from those studies include the following:

¶ "... Economic assessment indicates that ... collusion among insurers ... is highly unlikely to have caused the crisis." U.S. Department of Justice, *An Update on the Liability Crisis,* March 1987.

¶ "We have encountered no evidence to support any assertion that an industry conspiracy or collective manipulation has occurred, and there are strong theoretical and practical reasons to suggest that it did not." New York Governor's Advisory Commission on Insurance, *Insuring Our Future,* April 1986.

¶ "One significant problem with the collusion hypothesis is that the commercial liability insurance market is competitively structured." Harrington and Litan. "Causes of the Liability Crisis," *Science,* February 12. 1988.

¶ "No one brought to our attention, nor did our analysis reveal, evidence of non-competitive actions by insurers to raise prices in commercial liability insurance or to refuse to write new insurance." Virginia State Corporation Commission Bureau of Insurance, *Report on the Level of Competition, Availability, and Affordability in the Commercial Liability Insurance Industry,* November 1987.

¶ "Collusion cannot explain why the basic insurance policy has been restructured." Priest, "The Current Insurance Crisis and Modern Tort Law," *Yale Law Journal,* June 1987.

In part, the judgments cited above reflect the presence of alternative explanations for the liability crisis that are reasonable and are rooted in provable fact: namely, the sharp surge in the liability costs produced by the tort system, the effects of which were exacerbated by the industry's historic business cycle. Those explanations are addressed in greater detail in a later section of this paper. But even if those explanations did not exist, the conspiracy thesis is rebuttable by theoretical and empirical evidence.

Just as oak trees do not grow in the desert, industry conspiracies fail to flourish unless certain industry "environmental" conditions are met. The insurance conspiracy thesis is inconsistent with everything economists have learned about the requisites of effective industry collusion. Indeed, in recent decades the United States Supreme Court has taken the position that successful antitrust actions must be consistent with economic theory. Where the conspiracy charge is incompatible with economic theory—where the objective conditions to sustain the alleged conspiracy do not exist, or where the conspiracy is inconsistent with profit maximization goals—the lawsuit will be rejected.

Antitrust scholars are in agreement on a series of tests to measure whether the conditions necessary to conspiracy or collusion exist.

- **High Concentration Levels.** The central predicate to collusion is an industry cartel-like structure. Economists agree that the fewer the number of firms in a market, the greater the probability of collusion. And with any given number of firms in a market, the greater the concentration of market share among a few firms, the greater the risk of collusion. In industries with large numbers of players or with highly fragmented market shares, collusion is less feasible simply because it is difficult to achieve agreement and maintain secrecy when a large number of players, with divergent strategies and goals, must be brought into the fold.

The property and casualty insurance industry has over 3500 firms, 900 of which operate nationally. With no firm holding more than 8.6% of the market, concentration levels are extremely low. A widely-used measure of market concentration is the Herfindahl-Hirschman Index, or HHI. A study of HHI values by the United States Department of Justice found that concentration levels for the industry are extremely low; even in medical malpractice—a specialty coverage offered by a limited number of insurers—HHI values show low concentration, well below the level traditionally considered a source of competitive concern.

Even when market shares are broken down by line, concentration ratios remain low. The nationwide market share of the top four companies for general liability insurance net written premiums in 1986 was 24%. Although economists disagree on the precise level of market share for leading firms where collusion becomes a viable threat, concentration ratios for commercial liability coverage fail to reach even the lowest possible threshold where economists would be concerned about noncompetitive behavior.

- **High Entry Barriers.** Collusion is impractical in industries with low entry barriers to new competitors. If new competitors can enter a business with relative ease, they will sell to markets the conspirators have boycotted or sell at prices below the conspirators' price umbrella if it is profitable to do so. Low entry barriers are a well-accepted characteristic of the property and casualty insurance industry; the absence of such barriers facilitated the market entry of the new players who helped push prices downward in the early 1980's. The Department of Justice found that insurers can easily acquire licenses and expertise and begin selling existing lines in new states or provide new lines in states where they are already licensed.
- **Absence of Substitute Products.** To succeed, conspirators must have a monopoly over the product prospective purchasers are seeking. If purchasers can opt for a substitute product at better terms or at lower prices than are available from the conspirators, the plot will unravel and the conspirators could lose long-term market share. When large corporations and government entities self-insure, or smaller consumers create their own insurance pools and develop risk-retention groups, they are effectively opting for substitute products. Since those opting for self-insurance will frequently be the best risks from the insurer's perspective, the effect of an insurance conspiracy would be to drive away many of the industry's most attractive customers. In response to the inability of insurers to meet full coverage needs during the recent crisis, many attractive risks have indeed opted to self-insure; it would have been economically self-destructive for insurance firms to consciously adopt a strategy that would intensify the self-insurance phenomenon.

Indeed, while antitrust history is replete with examples of price-fixing conspiracies, there are *no* examples comparable to the liability crisis, when an industry does not offer to sell its product over an extended period of time. Firms do not collusively raise prices above normal levels and then refuse to sell the product. Insurers can make money when and only when they sell their product; a long-term boycott of broad classes of customers undermines an industry's basic profit maximization goal.

The actual history of property and casualty insurance markets in the 1980's reflects the flaws in the conspiracy thesis. A cartel-like industry capable of collusion should at least be able to maintain price discipline, yet in the early 1980's the industry experienced price wars that produced the worst financial losses in the industry's history in 1984 and 1985. When the liability crisis emerged in the mid-1980's, rather than manifesting the normal tendency to "cheat" on the cartel by broadening coverage while adhering to the other terms of the collusive agreement, insurers cut back the scope of coverage.

Insurance markets have from time to time been adversely affected by the structure of the property and casualty insurance industry. The problem, though, is not a tendency to collude in terms of pricing or other business practices. The problem is the opposite: that the industry's highly fragmented structure and competitive nature make it susceptible to occasional bouts of excessive and destabilizing competition.

IV. The Conspiracy Theory and Industry Profitability

Insurer profitability levels in recent years fail to support the conspiracy thesis. Since the purpose of corporate collusion is to maximize profits, the industry's profitability is relevant to the conspiracy issue. Indeed, among economists one of the criteria used for evaluating conspiracy claims is profitability. Certainly, a consistent claim among many proponents of the insurer conspiracy theory has been that collusion produced the excessive profitability that they allege the industry has achieved in recent years. While above-average profitability is obviously not proof of collusion, sub-par profitability does not square with collusion. The traditional view of economists is that firms that collude will achieve above-average profitability.

There is abundant evidence, which independent security analysts would readily confirm, that the industry's profitability has been substandard and, indeed, inadequate on a risk-adjusted basis.

• **The property/casualty insurance industry's 1987 after-tax profitability was substantially below the average for corporate America.** The universal standard securities analysts use to measure profitability is return on equity (ROE)—the return an industry generates on the equity shareholders have invested. Analysts consider ROE a better measure of profitability than absolute dollar levels of profit, which are largely a reflection of size. Measured by absolute dollar levels of profit, three companies—IBM, Exxon, and Ford—earned more together than did the entire property and casualty industry in 1987. The reason is not that those companies had extraordinary years in 1987, but that they are big companies.

In 1987, the property/casualty insurance industry earned $13.7 billion, for an ROE of 13.2%. By contrast, the 1987 ROE for the Standard & Poor 400 was 15.4%.

• **The property/casualty insurance industry has registered below-average profitability over time.**

The industry's return on equity can be measured either in terms of generally accepted accounting principles (GAAP), which most other industries use, or in terms of statutory accounting, which is the reporting system required by insurance regulators. By either test, over the 1977-1986 decade the industry was less profitable than its peers.

Over the 1977-1986 period, the P/C industry earned an ROE of 11.3% on a GAAP basis, and 12.4% on a statutory basis. By contrast, during the same period.

ROE's were 13.3% for the Standard & Poor 400, 13.3% for diversified financial companies, and 12.8% for commercial banks.

- **The consensus among independent securities analysts is that the industry's earnings are topping off, that current earnings are inadequate for the peak period in a cyclical industry, and that profitability will probably decline over the next several years.**

The industry's 1987 stock market performance reflected those pessimistic projections. For the second straight year, in 1987 property/casualty insurance stocks substantially lagged behind the broader market averages. For 1987 as a whole, the Dow Jones and Standard & Poor 500 averages rose slightly, while property/casualty stocks dropped by over 7 percent.

V. McCarran-Ferguson: A Related Policy Agenda

The thesis that insurer conspiracy caused the liability crisis lingers because the thesis is linked to a clear policy agenda: repeal of the 1945 McCarran-Ferguson Act, which affirms the primacy of the states in the regulation of insurance and provides the industry with a limited exemption from federal antitrust laws. Proponents of repeal have been unsuccessful in pleading their case with Congress in the past. The filing of the antitrust litigation, and the rhetoric of the attorneys general, can be seen as part of an overall strategy to reverse the political momentum against repeal of the McCarran-Ferguson Act.

A. Scope of Existing Law

Ever since New Hampshire established an insurance regulatory board in 1851, formal authority for regulating insurance activities has been vested in the states. In 1869, the United States Supreme Court buttressed the states' regulatory authority by holding that insurance did not involve interstate commerce, and thus was not subject to Congressional regulation *(Paul v. Virginia)*. But in 1944 the Court reversed itself, holding that insurance was indeed interstate commerce and was thus subject to federal antitrust laws *(U.S. v. South-Eastern Underwriters Association)*.

The Congressional response to that decision was the McCarran-Ferguson Act. Under the Act, the business of insurance is exempt from the Sherman, Clayton, and Federal Trade Commission Acts *if* the activity in question is regulated by state law. **The exemption, however, does not include any form of boycott, coercion, or intimidation; those activities remain subject to federal antitrust laws.**

The McCarran-Ferguson Act authorizes certain joint industry activities, including the collection of claims data and the development of standardized policy forms for insureds.

The Insurance Services Office (ISO) is licensed as a rating, rate-service or advisory organization in all 50 states, the District of Columbia and Puerto Rico. As such, it is authorized under applicable state insurance laws and regulations to develop advisory policy language and to develop advisory rates for various lines and sublines of insurance.

B. Public Policy Issues

In essence, the argument against McCarran-Ferguson is that any antitrust exemption is inherently anti-competitive, and that the authority to collaborate with respect to certain activities produced the conspiracy that led to the liability crisis. The second part of that argument—that the crisis was indeed a product of collusion—was treated in an earlier section. The issue addressed here is whether the McCarran-Ferguson Act is anti-competitive and thus anti-consumer.

On its face, it would appear peculiar that litigation allowed under an existing statute would be cited as proof that the statute is inadequate. But critics have charged that the authority for insurers to pool data on policyholder claims is tantamount to authority for insurers to collusively price-fix.

In fact, each insurer sets its own prices, as the aggressive price competition of the early 1980's and continuing marketplace competition illustrate. But without access to shared claim cost data, thousands of small insurers would lack the actuarial basis to establish prices and would be unable to compete. Shared cost data permits proper classification and rating of insurance—a retail hardware store will not want to be in the same risk class as a seller of pesticides—and enhances solvency regulation by state regulators. From a *competitive* perspective, authority to pool claim cost data is pro-competitive because it provides the information base allowing smaller insurers to exist.

In the recent lawsuits, the specific issue raised is the appropriateness of insurers developing common language for insurance policies. As one of the plaintiffs framed the issue, insurers should not be allowed to sit down and collaborate on *any* business activity. Each insurer should offer its own policy forms to consumers, or so the argument appears to go.

As noted in Section II above, complex policies written for sophisticated consumers in the commercial lines are often individually tailored to the needs of the insured. But for the vast preponderance of consumers, insurance is written on standardized forms. The policy objective behind authority for standardized policy forms is not convenience for the industry, but for those consumers. Without standardized policy forms, consumers would be forced to interpret the language of every policy form to determine how a given insurer had defined a collision, or vandalism, or a fire. Without an intimate understanding of policy form language, the consumer might be unaware that a policy offering what appeared to be a low price was providing drastically reduced coverage.

With standardized policy forms offering uniform terms of coverage, consumers can shop around for the best price. Without standardization, meaningful price competition would disappear.

In short, the McCarran-Ferguson Act was designed not to stifle competition but to promote competition, and to facilitate cooperation serving society's needs. The system of state regulation of insurance has served Americans well, producing a competitive marketplace and a regulatory framework responsive to the needs and preferences of the citizens of the individual states.

VI. Causes of the Liability Crisis: The Cost Explosion

Over the past several years, there has been an abundance of serious analysis of the causative factors underlying the liability crisis. Most of that analysis—by government bodies and commissions, and academics—has identified the surge in costs produced by the tort system as the central driving force behind the liability crisis. Some have also identified the industry's historic cyclicality as a contributing force.

That analysis is relevant not simply with respect to the conspiracy theory of causation, but because it ought to inform public debate over current policy alternatives. Although insurance markets have softened and coverage for most classes of risk has returned, insurance premiums are higher today on an inflation-adjusted basis than they were a decade ago. In short, the affordability crisis—the *perception* by insureds that rates are too high—may have diminished, but rates in fact remain high by historic standards. To the extent that the surge in claim costs described below continues, *real* insurance prices will continue to rise over time.

Shifts in the industry's financial condition and the insurance cycle may *delay* the translation of those rising claim costs into insurance rates at given points in time. But over the long term, the claim costs produced by the tort system will determine the rates paid by insureds as well as the costs absorbed directly by self-insureds. And for those activities where the evolution of the law is particularly problematic and unpredictable, insurance availability problems will recur.

The purpose of this paper is not to present a brief for any particular tort law change or even to argue the merits of tort reform in general. This section simply describes what has been established regarding the causes of the liability crisis. Whether as a nation we are investing too much or too little in liability protection, and whether court awards are too high or too low are subjective questions to which different observers will give different answers. The point here is simply that the largest component of the insurer cost base is the cost of settling claims, and in the liability area those costs will be determined by the costs produced by the tort system. Therefore, it is instructive to review the recent trends in that tort system.

The tort system affects the cost and availability of liability insurance in two ways. First, as court awards rise, insurer costs rise to the extent insurers pay those awards. More important, the claims settlement process through which most claims are resolved is directly affected by trends in court awards. In short, there is general agreement that insurer liability claim costs move in tandem with the amounts paid out in tort awards.

Second, the *predictability* of legal doctrine affects both insurance rates and availability. Where the law governing an activity is relatively stable or evolves slowly in a steady, predictable fashion, insurers can project future claim payments with reasonable confidence and set rates accordingly. But when the law governing a class of activities is in flux and is rapidly expanding in unpredictable ways (e.g., products liability, pollution), insurers in a competitive marketplace will respond in one of two ways. Some will simply drop out of the market on the grounds that the role of insurance is to spread risk, risks which cannot be predicted cannot be spread, and risks that cannot be spread are uninsurable. Thus the areas of tort law where liability doctrines are expanding most rapidly will experience the most severe insurance availability problems. Other insurers may weigh the risk of legal uncertainty differently and opt to provide coverage, but the rates they charge may build in an implicit added risk premium reflecting the risk that future injuries may be adjudicated in accordance with some currently unknowable theory of liability. Thus the unpredictable expansion of liability doctrine affects insurance markets in two ways: it raises rates and reduces availability.

Two recent tort law developments have profoundly affected the insurance mechanism. First, personal injury award levels have surged, producing sharply higher claim costs for insurers and higher rates for insureds. Second, tort liability doctrines have expanded in unpredictable ways, thereby pushing rates upward and reducing availability.

The effects of these developments are manifested in several ways:

A. Tort Awards

While overall tort litigation has not risen as rapidly as some other areas of civil litigation, from 1975 to 1984 federal tort litigation still rose five times faster than the U.S. population. From 1974 to 1985, federal product liability litigation alone rose 758%—63 times the rate of population growth.

More important from a societal or insurance perspective is the *cost* of that litigation. The leading source on litigation costs is the Institute for Civil Justice (ICJ), an independent, non-profit subsidiary of the RAND Corporation. Most of their analysis has concentrated on San Francisco County and Cook County, Illinois, where there is reliable historical data. *After* adjusting for inflation, average award levels more than quadrupled in both jurisdicitons between 1960-1964 and 1980-1984. In medical malpractice, average awards in both jurisdictions now exceed one million dollars.

B. Insurance Claim Costs

The insurance line that gives the best overall snapshot of the effects of the tort system is general liability, which includes product liability and other classes of business coverage. Between 1966 and 1986 general liability incurred losses rose 2664%, compared to a 238% rise in inflation, a 364% increase in medical care costs, and a 445% increase in the gross national product. In 1984 and 1985 alone, general liability incurred losses grew by 24% and 54%, respectively, compared with an average annual increase of seven percent in the preceding five years.

C. Self-Insureds

The experience of self-insureds graphically illustrates that the cost surge is a function of the tort system, not the presence or absence of insurance. In fiscal year 1986-1987, the state of Michigan paid out a record $45.5 million in court judgments and settlements, a 29% increase from the prior year. In fiscal 1980, those payments totalled only $6.6 million. From 1978 through 1985, claim payments rose 348% in Los Angeles and 407% in New York City.

D. Expansion of Liability Doctrine

Irrespective of their philosophical orientation, observers unanimously agree that tort law doctrine has undergone a genuine revolution in recent years, and that that revolution has frequently taken unpredictable turns. In product liability cases, the traditional negligence test has disappeared and defendants are held strictly liable for injuries, regardless of their degree of care. The defendant's claim that its product represented the "state of the art" no longer provides insulation against liability; plaintiffs have recovered where the risk created by the defendant's conduct was not only unknown but was scientifically unknowable when the harm was done. Indeed, the plaintiff no longer need suffer some actual injury to recover; in some cases, the plaintiff's *fear* that he might *someday* contract a disease has been found to be sufficient for recovery in cases involving toxic substances. Whether the fear of future harm should constitute a compensable injury is an issue for legal scholars and public policymakers to debate, but the unpredictable expansion of liability law can only have an adverse impact on the ability and willingness of insurers to cover such risks.

VII. Causes of the Liability Crisis: Insurance Business Cycle

Cyclicality has been a recurrent feature of insurance markets throughout modern history. Historically unprecedented interest rates, followed by a period of disinflation, helped produce the worst cyclical downturn in the industry's history in the mid-1980's. But even in normal times, while the price of insurance will ultimately mirror the costs insurers incur in settling claims, the industry's cyclicality produces periodic fluctuations in rates and availability independent of whatever is happening to underlying claim costs.

There are two keys to understanding the industry's cyclicality. The first is that the industry's capital base, which determines the industry's capacity to write the coverage society demands, is affected by the periodic ebbs and flows of capital worldwide in and out of the insurance business. The second principle is that insurers have two sources of income: underwriting income (essentially the difference between premium revenues and claim costs), and investment income (income from investing their assets).

When market interest rates are high, as they were in the early 1980's, insurers can reap substantial investment income, producing two effects. First, capital and new competitors enter the industry, creating new capacity and thus bidding down prices.

As with other competitive markets, insurance prices are responsive to the laws of supply and demand; when the supply of insurance (capacity) rises, prices will fall unless there is a commensurate rise in the societal demand for insurance.

The second effect of high interest rates is that they create an incentive for insurers to generate more premium revenue that can be invested at those high rates of return. The drive to generate those investment dollars also drives insurance rates down. The result in the early 1980's, of course, was severe price competition.

During the early 1980's, rapidly rising investment income subsidized rapidly rising losses from underwriting activity—losses created by the pincer effects of intense price competition and surging claim costs produced by the tort system.

From the perspective of insureds, that investment subsidy was not only welcome—it produced declining rates—but it was seen as fair, since premiums paid by insureds were discounted to reflect the investment value of those premium dollars to insurers.

With the sudden onset of disinflation, interest rates dropped, the investment subsidy declined, and record underwriting deficits inflated by the tort cost surge had to be addressed. Faced with those deficits and the loss of the investment subsidy, insurers individually moved to raise rates to bring them into line with rising claim costs.

In essence, the investment subsidy produced by record interest rates had masked the explosive growth in claim costs. The increases in rates over the 1984-1986 period were not to "make up" past losses, but to bring rates into balance with the growth in claim costs. Even in 1987, the industry lost a nickel on the underwriting side for each dollar in premium revenue. That is, each premium dollar produced $1.05 in costs. That represents an improvement over the average loss for the last five years, but it is a significantly worse record than in any other period over the past two decades.

The effects of the insurance cycle are real, but they should not be overstated. In today's insurance market, rates are where they are not because of some capacity shortage—the uniform view of independent securities analysts today is that the industry's capacity is adequate—but because of the pressure imposed by steadily mounting claim costs. Over a short period, the cycle can affect insurance rates; but the unalterable fact is that in the key liability lines, *over the past decade* the claim costs produced by the civil justice system grew far more rapidly than premiums.

In short, inadequate pricing in the early 1980's—the effects of the cycle—contributed to the *suddenness* of the 1984-1986 price hikes. But the level to which rates have risen in recent years is a product of the tort system, not the industry's cyclicality.

Appendix

A. Claims-Made Form

The first major use of the claims-made form occurred in the area of medical malpractice, where doctors, hospitals and others working in the medical care field can be sued for negligence. The policy for doctors and hospitals was introduced in the mid-1970's and now is the dominant and accepted insurance policy form used in the medical field.

The rationale for a claims-made form arose from the fact that in the medical area, there can be a long delay between the time when an accident occurred and the time when a suit is filed. Thus a person could undergo a stomach operation in 1978, but an injury caused by that operation might not manifest itself until 1988. The injured person files a suit against the surgeon. Under a claims-made insurance policy form, the surgeon would be covered under the insurance policy written in 1988, the year the claim is made. Under an occurrence form, the surgeon would have coverage under the policy written in 1978, the year of the operation, when the accident occurred. Beyond producing greater predictability for the insurer, the claims-made form has advantages to the injured person, because the policy is current. The insurance company is in business today, and the limits of liability—the amount of coverage available—reflect today's legal climate, where multimillion dollar awards in the medical field are much more common than they were years ago.

In the area of products liability insurance, the emergence of long-latent diseases has also created a similar need for the claims-made form. The best known example of long-latent disease is asbestosis, a disease of the lungs, contracted by exposure to asbestos fibers. Asbestosis symptoms may not show up until as many as forty years after exposure to the fibers. Under an occurrence form of policy, claims filed by persons suffering asbestosis are covered, if at all, by liability policies written many years ago, when the person was exposed to the fibers.

Those occurrence policies written decades ago were drafted in a very different scientific and legal world than today, and coverage may be very inadequate as judged by today's standards.

Given the experience of asbestos and similar products giving rise to long-latent diseases, insurance companies are understandably reluctant to write policies for products sold in 1988, which may be found to cause severe injury 20 to 30 years from now. How can a premium be estimated to cover losses for diseases which may not even exist today? The claims-made form addresses this problem. Under the claims-made form, premiums can be calculated because claims can be estimated accurately. The size and number of claims for a given injury or disease caused by a product are known. So a calculation can be made of the size of premium needed to cover such claims. This is not possible under the occurrence form.

B. Pollution

Insurance companies are very reluctant to offer coverage for pollution, known in the business as Environmental Impairment Liability (EIL) coverage. This is because they view the risk of pollution in many cases as uninsurable. The claims associated with pollution in many cases cannot be predicted in any precise way. The legal climate surrounding pollution is highly uncertain and the costs associated with this risk can be counted in the billions of dollars. So just as insurance companies regard war as an uninsurable risk because of the potential for a devastating loss, they also regard pollution in many cases as uninsurable.

In keeping with this basic thrust, in 1973, the comprehensive (later changed to commercial) general liability policy (CGL), the most common policy used to cover businesses for many of their liability exposures, was amended to exclude coverage for pollution that was gradual in nature. The discharge, dispersal, release or escape of pollutants was not covered unless it was sudden and accidental. Coverage for gradual pollution was made available in separate policies, distinct from the CGL, by a number of insurance companies, but on a limited basis.

The extent of CGL coverage for pollution was disputed frequently in the courts. Some courts interpreted the exclusion to mean that gradual pollution *would* be covered as long as the effects were unexpected or unintended from the policyholder's viewpoint. For example, a 1983 Washington state case *(United Pacific Insurance Company v. Van's Westlake Union, Inc.* 664 p.2d126 [Washington, Ct., App 1983]) held that a leak from a gasoline tank that occurred over an extended period of time was "sudden and accidental," since that leak was neither intended nor expected.

In 1984, this line of thinking took a new turn in the Jackson Township, New Jersey case *(Township of Jackson et al v. Theodore R. Beekman et al v. American Home Assurance Company et al* [New Jersey Superior Court, No. L-29236-80]). A key issue in this trial was whether the pollution caused by the township constituted one accident or "occurrence" or multiple occurrences. The court treated the gradual seepage that had occurred as multiple occurrences, thus permitting recovery beyond the policy limit because the limit was judged to apply to *each* occurrence. In effect, the court had overridden policy language excluding coverage for gradual pollution. From an insurer standpoint, the court was saying that insurers would be held accountable for risks the insurers had explicitly determined they did not intend to cover.

As awareness of the enormity of the pollution problem grew, public pressure forced Congress to take action to speed the clean up of hazardous waste sites. In 1980, Congress passed the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), otherwise known as Superfund, which was amended and renewed in 1986.

The passage of Superfund was expected to facilitate the clean up of waste sites by making the responsible parties bear the ultimate financial burden of the cost through a restructuring of the liability law. Under Superfund, parties found responsible for having generated the waste are strictly, jointly and severally liable.

The party can be held liable for the costs that governmental agencies incur in responding to the pollution threat and for damage to natural resources. Under the statute, the parties can be held liable to the federal government in addition to their common law liability to any other party claiming injury or property damage from the pollution "occurrence."

The Superfund legislation created many problems for business and insurance companies. Strict liability, for example, imposes liability on a defendant regardless of whether the defendant was negligent. Thus a company that disposed of its wastes in a responsible manner may be held as liable as a company that took no safety precautions whatsoever. In ignoring the concept of fault, Superfund negates a fundamental principle of insurance and tort law, which is to encourage prudent behavior.

Under the joint and several liability provision of Superfund, one company can be held responsible for the misconduct of all the other parties that dumped their hazardous waste at any given site, even if it contributed in only a minor way to the total injury or damage. Thus once again the behavior of each individual party becomes irrelevant. Moreover, Superfund imposed liability in a retroactive fashion so that insurance companies have had to pay for losses that were never envisaged when the original policies were issued and for which no premium was collected.

In addition to severely discouraging the market for environmental impairment liability insurance, the strict, joint and several liability provisions of Superfund have caused an explosion of litigation involving federal agencies.

Given the increasing problems surrounding the pollution issue, the CGL exclusion for pollution liability was revised in 1986 to exclude not only gradual pollution but also to exclude coverage for sudden and accidental pollution except in very limited circumstances relating to a policyholder's products or services.

The revision does not eliminate all insurance coverage for pollution. Broad coverage is available under environmental impairment liability policies. However, the market is limited because the nature of the risk and trends in statutory and common law remedies, particularly the provision of Superfund, make underwriting decisions extremely difficult.

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Senator METZENBAUM. Senator Simon?

Senator SIMON. Mr. Chairman, I regret that I have to go to another meeting, and I hope to get back here, but just a couple points of clarification.

Number one, we talk about this McCarran-Ferguson Act that Congress passed. The reality: It was put in in a conference committee.

Now, the three of you know what conference committees are like. This wasn't something that Congress took a long and careful look at to decide we are going to provide this exemption for the insurance industry.

Second, my friends in the insurance industry say, "We're not using this exemption in the McCarran-Ferguson Act." If that is not being used, other than for sharing risk information—where we are in agreement that that exemption should be there—if it is not being used, why does the insurance industry so vigorously fight the repeal of the Act?

And then, finally, Mr. Chairman, it just seems to me if we say to two people who are running shoe stores in a small community in Texas or Massachusetts or New York, if you get together and do certain things, you are going to be tossed in jail for 3 years—or you can be—but we say to one of the most powerful financial industries in this Nation that they can go ahead and do things that would be illegal for those shoe stores, it just seems to me we have distorted this free enterprise system, and what we have to do is to get it back on course.

We appreciate your testimony here today, and we appreciate your leadership.

Senator METZENBAUM. Mr. Mattox.

Mr. MATTOX. Senator, I appreciate the logic that my friend Paul Simon just expressed, and I think that there is one thing I would further point out. Despite our arguments, I think Senator Hatch simply did not understand that he was arguing apples and oranges, and that we in the States simply believe that competition is good in the industry, price-fixing is bad; we prefer that it not happen; and if the State laws were adequate to handle all these problems, we wouldn't be here dealing with them, but because of the exemption that is provided by McCarran-Ferguson, we using State laws do not have as much capability.

One other point, when we were talking about the insurance lobbyists, I thought was interesting, too, is at the same time this industry is talking about dire straits, the industry in effect paid no Federal income taxes, Senator—no Federal income taxes—between 1975 and 1984, because they received net tax credits of $125 million even though it had net gains based on the way we figured them, of $75 billion during that time period. Those figures are provided by the GAO. But I want to point out to you that in that 2-year period of time there, they increased their profits from $2 billion to $23 billion during that same period of time—pretty hefty profits to take place in a free, competitive market, particularly as Adam Smith would have understood it to operate with laissez-faire economic theories.

I am surprised that Senator Hatch doesn't understand the free enterprise system any better than he does.

Senator **METZENBAUM**. Thank you.

Mr. Shannon, you were bursting at the seams when Senator Hatch was speaking.

Mr. **SHANNON**. I think we have covered the points, Senator.

Senator **METZENBAUM**. All right.

Senator Specter, we are happy to have you with us.

Senator **SPECTER**. Thank you very much, Mr. Chairman.

I am sorry I could not be here sooner. I have spent most of the morning on the Floor, where we have welfare reform up, but I'll take a look at the record. It is a subject of great interest to me, and I am delighted to see the prominent attorneys general here this morning. I commend you for your work. I have some idea as to what you are doing.

The question I have—and I won't go over ground you have already covered, at least I hope—but one point of inquiry is to what kind of timetable do you see on this litigation. We have had extensive consideration of this issue. I, for one, have expressed publicly my concern about cancellations, about raising of premiums, and have looked for some relationship to the antitrust laws.

There are some very strong allegations made in the litigation started by the eight States back in March of this year, and I for one will be very interested in the quality of your evidence, what is going to be established, what will be proved here.

I know attorneys general don't make these allegations lightly, but the trial will disclose the substance of the charges and what the defense are and give us a much better picture. It may be that there will be a very different perspective in the Congress, depending on what we see, if we really see strong evidence of collusive practices.

My question is what kind of a timetable do you anticipate when this evidence will be on the record?

Mr. **SHANNON**. Senator, if I could just take a stab at that, as you know, it is very hard to predict, but I will say this. Unlike much litigation in which we are all involved, we had to do a very, very thorough investigation prior to filing suit here.

We spent 2 years; we reviewed 100,000 documents; we interviewed a couple hundred people. Some of that evidence can be made public now. Some of it cannot be, however, because under some State laws, civil investigatory demand information cannot be used except in the course of litigation. But I think the fact that we did such an extensive investigation prior to filing this suit makes it possible, perhaps, to get this trial schedule on a faster track than we would normally expect under these circumstances.

Mr. **ABRAMS**. And Senator, on June 23, there is the first conference in this case, so we will have a better idea as to how the insurance companies view these allegations, what their mood is in terms of the ultimate resolution of the allegations that we have made. So I think that will be the first sign in terms of whether we are going to have to go all the way through to trial in this case or whether there will be a resolution of it earlier than that.

Senator **SPECTER**. When the trial judge asks, "Is the State of New York prepared to proceed to trial?" What will the response be?

Mr. **ABRAMS**. The very next day? Are you talking about the very next day?

Senator **Specter**. Maybe that afternoon.

Mr. **Abrams**. Here is the chief of my Antitrust Bureau, Lloyd Constantine.

Senator **Specter**. I am about to ask Massachusetts and Texas the same question.

Senator **Metzenbaum**. Well, since Pennsylvania joined the action today, as I understand it, we ought to ask the attorney general of Pennsylvania, also.

Senator **Specter**. I agree. I'll ask myself the question.

Senator **Metzenbaum**. Go ahead.

Mr. **Constantine**. I believe that if Judge Schwarzer would order us to trial, we would say we are ready to pick a jury.

Senator **Specter**. Good.

Are you ready in Massachusetts?

Mr. **Shannon**. I think we are. I should say that we are three of the first five States involved in this. We have been involved in this for a couple of years. This is multistate litigation. By the end of today, we'll have 19 States involved, so we'll have to bring a lot of people in. But we're pretty close, Senator, and we'd like to see a quick trial on this.

Senator **Specter**. And Texas?

Mr. **Mattox**. Our action is filed in State court, not in Federal court, Senator. I anticipate that there will be additional discovery on both sides of the issue, but by the time the trial judge sets it for trial, we'll be ready and anxious to do it.

Senator **Specter**. So you are not one of the eight States which filed—you filed on the same day in the State court?

Mr. **Mattox**. The same day. Senator, our lawsuit is somewhat different than the others. I have described it as kind of watching both ends of the alley. We don't want the reinsurance carriers that the other States are building at least a portion of their case around to point their finger at the domestic carriers and say they did it——

Senator **Specter**. But you are in the State courts, and you are not under the Federal antitrust laws.

Mr. **Mattox**. No. Our State law is virtually the same as the Federal antitrust law, and we are also suing them under the Consumer Protection Act in Texas, which gives substantially greater damage potential.

Senator **Specter**. Well, I am glad to see you moving forward. One of the greatest problems we have—probably the greatest problem—is finding out what the facts are. That is what we lawyers always have a hard time doing. If we can once find the facts, we have less problem agreeing on where we ought to go from there. But sitting on this committee and other committees, we sit countless hours and hear people on both sides, and we aren't very good at honing down issues. We are barely qualified to ask questions and get responsive answers. We make so many speeches on this side of the podium.

But I am delighted to hear it is going forward, and when we get those facts, it could be very helpful and very instructive as to how this committee and how the Senate and how the Congress will feel about it.

Thank you very much, Mr. Chairman.

Senator **Metzenbaum**. Thank you, Senator Specter. We are always happy to have you participate with us.

Thank you very much, gentlemen.

Now we will hear from Mr. Craig Berrington, general counsel, American Insurance Association, in Washington, who is accompanied by George Priest, Yale Law Professor and the AIA consultant.

Mr. Berrington, we are very happy to have you with us, sir. I am sorry it took so long to get to you, and in all fairness to you, only limited by the constraints of our own time so we might hear panel three, I had asked you to hold your time to 10 minutes, but since we gave the three attorneys general so much time, if you need 15, 20 minutes, whatever, please feel free. We want to hear your full statement.

STATEMENT OF CRAIG A. BERRINGTON, GENERAL COUNSEL, AMERICAN INSURANCE ASSOCIATION, WASHINGTON, DC, ACCOMPANIED BY GEORGE PRIEST, PROFESSOR OF LAW, YALE UNIVERSITY, AND CONSULTANT TO AMERICAN INSURANCE ASSOCIATION

Mr. **Berrington**. Thank you, Mr. Chairman. We appreciate every little opportunity we can get this morning to make the case, because we have heard a lot of hot rhetoric this morning—some of it has actually been about the litigation.

Senator **Metzenbaum**. It is a little hard to hear you, sir. Would you pull the mike closer?

Mr. **Berrington**. We have heard a lot of hot rhetoric here this morning—some of it has actually been about the litigation. We want to tell you a little bit more about it. We would be delighted to talk to you about the McCarran-Ferguson Act itself.

My name is Craig Berrington. I am general counsel of the American Insurance Association. I am accompanied by George Priest, who is Olin Professor of Law at the Yale Law School, and directs the Yale Program in Law, Economics and Public Policy. Professor Priest teaches antitrust law; he is one of the Nation's leading legal scholars, and he has been helping AIA with analyzing the litigation, especially the relationship of the litigation to the liability system.

After I am done, Professor Priest will have a statement, and then we'd be glad to take whatever questions the committee might have.

This antitrust litigation, Mr. Chairman, was initially brought by the attorneys general of several States. Today, as was indicated earlier this morning, and as I have expected for weeks, the original attorneys general will be joined by additional ones, who will make their announcements or who have already made their announcements, in a wholly-predictable media event, timed to coincide with this hearing.

The history of this type of litigation, though, Mr. Chairman, is that plaintiffs come and plaintiffs go, as the facts get fully explored. Indeed, we have seen that already in the private litigation spawned by this lawsuit, where some of the major private suits have already been dropped.

In the end, of course, this litigation will be decided on the merits, not by counting the number of plaintiffs. So let's talk about the merits a little bit.

When the AG's first announced their suits, and here today in bold rhetoric, they have claimed that these suits hold the key to the liability insurance crisis of the mid-1980's. But I suggest you read the complaints, because in reality, Mr. Chairman, this litigation is quite narrow, it is quite technical, and it primarily concerns three discrete issues: first, the development of a new commercial liability insurance policy form called the "claims-made" form; second, the continued availability and content of an existing commercial policy form, called the "occurrence" form; and third, a clause in those two forms that excluded pollution coverage from those specific policies, but had nothing to do with the availability or nonavailability of pollution insurance generally.

The AIA is not a defendant in this litigation, but we believe that the lawsuit raises important public policy questions, as was amply demonstrated this morning, about the role of State regulation, the extent of competition in the insurance business, and the true causes of the liability crisis. We can't litigate the case here today, and neither should the attorneys general, but we can discuss these underlying issues in the context of the litigation.

In that respect, there are five points I would like to quickly make.

First, it is important to understand that the guts of this lawsuit is the assertion that the process undertaken to develop the claims-made form for commercial liability insurance violated the antitrust laws. But Mr. Chairman, in fact, this process was undertaken pursuant to State law—State laws enacted under the Federal umbrella of the McCarran-Ferguson Act—and was closely supervised by State insurance commissioners to assure that the public interest be served.

It is extraordinary now that litigation should be brought by one group of State officials, the attorneys general, to hold these defendants liable for their participation in a State-authorized insurance form development process, controlled by another group of State officials, the insurance commissioners.

Let me explain. Under McCarran-Ferguson the insurance code of every State, including the States of the AG plaintiffs who were here today, has authorized cooperative activity to develop insurance policy forms, including the claims-made form. That is done to serve important public policy purposes. Without standardized forms, there is no way for consumers to accurately and fairly compare price; without standardized forms, there is no way to collect the data which the chairman says he would like to have; and, without standardized forms there is no way to collect data in a way which is meaningful. In addition to authorizing this collective activity in the development of policy forms, most State insurance codes specifically require that those forms be filed with insurance commissioners and approved by them.

The policy forms that are at the heart of this lawsuit, Mr. Chairman, were not even approved by State insurance commissioners until the liability crisis that the AG's were talking about, today was well under way and indeed, almost over.

In every State, the insurance commissioner has the authority to prohibit for good cause the continued use of an insurance form. Further, insurance commissioners are authorized to disapprove and enjoin any activity by an insurer or insurer organization which is unfair, deceptive or discriminatory.

I think it is important to emphasize that point because it goes to questions that Senator Hatch raised and questions that Senator Heflin raised earlier. There is broad authority under State law for State officials to have remedied any violations of law that they believe have occurred. And if the attorneys general feel hampered by the McCarran-Ferguson Act—and I don't think they are very much—but if they feel hampered by that law, the fact is that State unfair practices acts are broader, much broader, and there is no activity which they allege occurred—and that they allege was improper—that could not have been attacked directly under State law rather than in this collateral way under Federal antitrust law.

Senator METZENBAUM. Mr. Mattox had said that most of the State laws provide for State action, but there is an exemption provided for action protected or exempted under Federal statutes. Is that pretty much accurate?

Mr. BERRINGTON. Well, the statement is untrue, and it is not very enlightening. In fact, as Mr. Mattox said, he has brought his action in State court under State law.

The Federal McCarran-Ferguson Act merely allows the States to establish regulation of the insurance industry. It does not tell the States how to regulate the insurance industry. It does not tell them not to apply State antitrust laws to the insurance industry. What it says is, if a State regulates the business of insurance, then application of Federal antitrust laws will be stayed; you will not enforce those laws.

Now, Mr. Mattox' State of Texas is a State that has an Unfair Practices Act. I think it is extraordinary that he should talk about the rates of insurance in Texas. Every rate in the State of Texas is approved—not only approved; it is determined—by a State board. It is one of those States in which insurance companies don't make the rates; the State makes the rates. So it is improper for Mr. Mattox to be complaining here that the rates are too high; he ought to be complaining—and he has every opportunity to do so—to that State Board when it makes decisions.

Senator METZENBAUM. You said the States make the rates.

Mr. BERRINGTON. In Texas the State does make the rates. I don't advocate that, I'll let you know, but the State of Texas does.

Senator METZENBAUM. In most States, it is pretty much file and sell, isn't it?

Mr. BERRINGTON. That's not quite right. It depends on the line of insurance as well as the State. You can look at it, Mr. Chairman, as a continuum, really, and on one end of the continuum, you have situations like in Texas, where the State actually makes the rates; in other States, like California and Illinois, the option is toward a free competitive market where insurers just compete down the line.

And then in other States, there are different points on that continuum, and also in different lines of insurance.

Senator **Metzenbaum**. But in my own State—and I might say I was the author of the legislation that supposedly was going to provide for some State regulation back many years ago—but the fact is that in my own State, you file and sell; and Ohio is considered a reasonably good State as far as regulation, but there really is no prior approval of rates. And if you talk to the Commissioner about the rates, he says, "I have no jurisdiction over that matter."

Mr. **Berrington**. Well, I would prefer, and I think we all would prefer, a free market system. In Ohio, in the workers' compensation system, they are State-made rates——

Senator **Metzenbaum**. Well, that's a different subject.

Mr. **Berrington**. Well, no, it isn't a different subject.

Senator **Metzenbaum**. That's a different subject. You are trying a diversionary tactic.

Mr. **Berrington**. No, it isn't, no, no.

Senator **Metzenbaum**. You don't like the State-made workers' compensation, but let's talk about insurance.

Mr. **Berrington**. I am. Let me explain, Mr. Chairman, and I appreciate the time. When you talk about the McCarran-Ferguson Act and repealing McCarran-Ferguson, you are talking about workers' compensation, too. When you are talking about the State insurance code, you are talking about workers' compensation, too. So you can't talk about repealing or amending McCarran without that effect.

But the point I wanted to make—and I'll be glad to answer further questions—the point is that through this process not only were there laws on the books that empowered insurance commissioners to oversee the development of insurance policy forms, but those powers were in fact exercised energetically and forcefully throughout this entire process. You wouldn't have gotten that impression from what we heard a little bit earlier.

But the fact is that from the time the Insurance Services Office began research in 1977 on the development of new liability insurance forms, through 1982, when ISO first published exposure drafts, and those exposure drafts were widely circulated to regulators, to customers, to companies across-the-board—there was intense debate, especially following those exposure drafts in 1982; and the State insurance commissioners controlled the outcome. They held hearings; hearings were held across the country. Indeed, the three States that were here today, Texas, Massachusetts and New York, all held hearings. In addition to that, under the auspices—and I am sorry Senator Simon isn't here—under the auspices of the Illinois Insurance Commissioner, large public hearings were held in Chicago in July 1985, where representatives from all points of view were closely questioned by a panel of 18 insurance regulators. This exercise of insurance commissioner authority was unprecedented. There was no issue in the modern history of the insurance business, Mr. Chairman, that received more public scrutiny, more insurance commissioner involvement, than this one.

And the year following that debate in Chicago, decisions were made by the States on what to do. Forty-eight States approved a revised version of the standard occurrence policy; 44 States approved new claims-made forms, oftentimes only after requiring changes. Indeed, in the State of Minnesota, where the attorney general is a plaintiff in this lawsuit, the State actually passed legislation, Mr. Chairman, saying that the State could only—could only—adopt the ISO form.

This is a picture of a regulatory system working as it should, with insurance commissioners closely overseeing the process, making decisions and permitting only those claims-made forms to be used that they thought were consistent with the public interest.

Second, Mr. Chairman, based on the allegations in the complaint, there simply was no boycott. Supreme Court law and Federal case law, as well as the legislative history of the McCarran-Ferguson Act, amply demonstrate that an agreement concerning the terms of policy coverage as well as decisions not to issue a particular policy form do not constitute an illegal boycott.

In the Supreme Court's 1978 decision in the *"Barry"* case, the Court defined "boycott" as "a concerted refusal to deal on any terms". The Court made clear that a boycott does not include decisions by insurers on what terms of coverage they will offer or what terms will be placed in a standard form policy.

The point was reemphasized just recently in the *UNR* case, where the Federal District Court held that allegations of an actual agreement among insurers to market a new claims-made policy, an allegation which I think is broader than the allegation being made in the lawsuits being discussed here, failed to state a Federal antitrust claim. In dismissing the plaintiff's argument, the Court stated emphatically: "An agreement to change to a new type of policy is not a boycott and does not constitute coercion or intimidation."

The legislative history of McCarran-Ferguson is also clear that agreements concerning terms of coverage do not constitute a boycott.

In the Supreme Court's *Royal Drug* decision of 1979, the Court emphasized that the drafters of the legislation intended to exempt from antitrust attack certain cooperative activities regarding insurance, including the development of policy forms.

Thus, Mr. Chairman, the plaintiffs are straining to transform into a boycott the legitimate State-sanctioned decisions by insurers on the terms of coverage of an insurance policy form. What the plaintiffs are really doing is misusing the boycott exception to attack the legitimacy of State insurance regulation itself.

Senator **METZENBAUM**. Mr. Berrington, would you think it reasonable to ask you to wind up in another 5 minutes or so? We have four other witnesses coming.

Mr. **BERRINGTON**. Well, I'll be able to finish this statement, I believe, in 5 minutes. We would hope to have some time to make our case, since the plaintiffs in the case had several hours to do so. And what we are dealing with are purely allegations, Mr. Chairman.

Senator **METZENBAUM**. I don't want to be unfair. You are absolutely right, and I don't want to be unfair to you timewise, and if you can't, I'll just have sit through it. But each Party has their meetings on Tuesdays, usually around 12:00, but I can make it a little later. But I do want to hear the other witnesses, so do the best you can with the 5 minutes, if you would.

Mr. **BERRINGTON**. We'll do the best we can, sir.

Senator **METZENBAUM**. Thank you.

Mr. **BERRINGTON**. Thank you.

Senator **Metzenbaum**. Let me say one other thing. I, as the prime sponsor of the bill, want you to know that a long time ago, Mr. Vagley of—that is your organization——

Mr. **Berrington**. Yes, the President of the American Insurance Association.

Senator **Metzenbaum**. Yes. He was in to see me, and I would like the insurance industry to understand that I know some of their concerns have to do with the question of the camel's nose under the tent, the question of whether or not there is any implication or thought of going forward with Federal regulation, and some other concepts as well. As the principal sponsor, I'd like to convey the message that my door is open; I'd be prepared to try to see if we could effectuate a compromise if there is something that could be worked out. We may have the votes now, tomorrow, or next year—whatever. But if the insurance industry is disposed to try to come up with a middle ground, this Senator is prepared to at least sit down and discuss the subject.

Mr. **Berrington**. Well, we appreciate those comments and that openness, sir. I know that Bob Vagley enjoyed his spirited discussion with you that day. We do talk with committee staff frequently, and we would appreciate the opportunity to see you and to further discuss these issues, at a time that would be convenient for you.

Senator **Metzenbaum**. I would be happy to do so.

Mr. **Berrington**. There was another aspect of the boycott allegations in this lawsuit that I wanted to particularly touch on this morning—the Texas boycott allegations, which raise even more significant public policy concerns.

The Texas suit, uniquely among the suits filed, claims that the defendants violated the antitrust laws by advocating changes in the Texas tort system. Indeed, Attorney General Mattox made that point again here this morning. I believe that claim is wrong; it is dangerous; it endangers our constitutional rights of free speech and to petition the Government.

I was incredulous, listening to Mr. Mattox emphasize that this morning, that somehow, the advocacy of changes in State law amounted to an antitrust violation. Well, let me assure you, Mr. Chairman, he has not only talked about it; he has it in his suit, unlike any of the other lawsuits.

But as the Chairman knows, there is an absolute constitutional right to make advocacy statements and for competitors to join together to advocate changes in the law.

Under the Supreme Court's *Noerr-Pennington* doctrine, it is clear that no violation of Federal antitrust law can be predicated on lobbying and other similar concerted political activity by businesses to obtain legislative or executive action.

The Texas claim appears to me to be essentially an effort by the Texas Attorney General to silence advocates of Texas tort reform and, therefore, raises unsettling questions about the proper use of governmental power. Under the guise of enforcing antitrust laws, public officials are not entitled to harass or intimidate individuals engaging in legitimate political activity simply because those individuals agree with the opposition's views on important public policy issues.

Senator **Metzenbaum**. In view of the Supreme Court decision, I think it was yesterday, may that not be changed if they are concerted activity to bring about a change in the ISO position, which is not a governmental agency?

Mr. **Berrington**. Mr. Chairman, no, that's not correct, I believe. The Supreme Court's decision yesterday had nothing to do with petitioning a State legislature for changes——

Senator **Metzenbaum**. I understand that. But ISO is not a State legislature.

Mr. **Berrington**. No. ISO operates strictly under State law; it is licensed and regulated under State law. It does only what State statutes and regulations say it can do. So the activity of ISO's members is regulated by the States in which ISO exists.

And I believe we would all agree that the *Noerr-Pennington* doctrine, which protects the right to petition the Government, is a critical doctrine and that the antitrust laws should not be allowed to eviscerate it.

The Texas courts have also specifically approved and referenced the *Noerr-Pennington* doctrine, and I believe even if they hadn't, it is a fundamental right.

So it is my view that that particular part of the boycott allegation is not just legally wrong and unsupportable, but dangerous as well.

The third substantive area, Mr. Chairman, relates to the availability of pollution insurance. The complaint alleges that a conspiracy of the defendants caused the availability of pollution coverage to be eliminated, or drastically reduced. A document was produced this morning, assertively dealing with that, a document dated June 2, 1987, by British insurers operating under British law. But I must say that I read this part of the lawsuit with utter disbelief. Those who have studied the issue know full well why pollution coverage was eliminated from the standard commercial insurance policy. It did not happen in 1987; it happened back in 1984. It is not a secret; it was no conspiracy. It resulted from court decisions.

The ISO standard form policy for commercial liability insurance, in fact, had included a pollution exclusion going back to 1970. That pollution exclusion was subject to one exception, and that exception was solely for a pollution event that was both sudden and accidental. If the discharge of a contaminate was both sudden and accidental, then the damages from that discharge would be covered. But as exemplified by the now notorious *Jackson Township* case in 1984, the courts ignored the term "sudden" and ruled the pollution exclusion clause did not bar coverage for incidents which developed over decades.

As insurers could no longer rely on an appropriate and predictable interpretation of this policy language, they did what you would do—they decided that the policy needed to be changed to totally eliminate the offending language so they could write commercial insurance for everybody else. But this change, too, was only put into effect where State insurance commissioners determined that it would be proper to do so. At the same time that the narrow pollution provision was taken out of the standard policy, another policy, which dealt solely with pollution issues, was made available. So any individual who needed pollution insurance was not kept from getting that insurance by the failure of an appropriate policy being available, a policy approved for use by State commissioners.

Fourth, Mr. Chairman, is the question of competition in the insurance business. You have heard a lot about that this morning, too. But by every standard measure of market structure and market performance, the industry is highly-competitive. The level of concentration is low; there are over 3,500 firms, as you heard this morning, and none has more of a market share than 8.6 percent.

It was mentioned that in some lines, there are very few insurers. In fact, the only lines where there are very few insurers are those lines in which it is not possible to make a reasonable underwriting prediction and a reasonable profit. Medical malpractice is one of those. The States have stepped into the breach to provide this type of insurance; and now the States have huge deficits in their own medical malpractice insurance programs.

Profits in the industry, although cyclical, are on average below those of other industries. From 1970 to 1985, a period that encompassed two complete underwriting cycles, the average return on net worth was 10.1 percent in the property/casualty insurance industry compared to 11.8 percent for a group of non-insurance industries.

In this connection, Mr. Mattox had some charts this morning that the Chair asked be introduced into evidence. I think that is fine. Mr. Mattox' charts are quite interesting. He picks his dates with great care, Mr. Chairman. One of those charts starts in 1985 and goes to 1987. Another one of those charts ends in 1985. There is not a whole lot of congruence among those charts, but they do serve Mr. Mattox' purpose for telling part of the story—but only part of the story.

I have the completion of those charts. We would like to enter those into the record as well.

Senator METZENBAUM. May we see them?

Mr. BERRINGTON. You certainly may. Here, Mr. Mattox had a chart which showed insurance industry net income starting from 1985 and going up. What he did not show was the dramatic slide in net income starting in 1981.

And there were other charts relating to profitability, to insurance industry property/casualty stocks. I would like to add to that, since articles were quoted earlier, an article from Business Insurance which goes into more depth and covers more years than Mr. Mattox' does.

But the point is that you need to be careful with charts. You need to be especially careful in using raw numbers. The only way, really, to get an assessment of profitability is to look at return on net worth, and the return on net worth in the insurance industry, as economists will tell you, is much lower than the average of the Fortune 500.

Now, just a few more minutes, Mr. Chairman, on the causes of the liability crisis, because there was a great deal of talk about that here this morning.

The fact is that the contentions made by the attorneys general have been rejected by economists and antitrust experts. The AG's say there was no review by the Federal Government on the causes of the liability insurance crisis. That is wrong. There was a Federal review; it just came to a different conclusion than the AG's wanted.

The insurance crisis of the mideighties occurred at the bottom of an insurance cycle. The cycle was unprecedented in duration and severity. And the reason for that cycle was quite clear—the naturally cyclical tendency of the industry was severely exacerbated by conditions in the national economy generally and the expansion of tort liability over the previous decade. None of the attorneys general up here put the situation in the context of the economy.

What was happening during the late Seventies and the early Eighties? Growth and productivity in the economy were stagnant. Inflation reached rates higher than at any time since the Civil War, and the economy went into the deepest depression since the Great Depression. And then interest rates plunged.

No other industry, Mr. Chairman, was immune from the roller-coaster effects of that economic dislocation. It is simply unreasonable to expect that insurance would be.

Mr. Chairman, the case that was presented this morning by the AG's is not going to succeed in court. I would hope, therefore, and I would expect, that no legislative action would be taken or contemplated based purely on those allegations made in the lawsuit.

Thank you very much. I appreciate your giving us the time.

[Statement of Mr. Berrington follows:]

STATEMENT
OF THE
AMERICAN
INSURANCE
ASSOCIATION

TESTIMONY
OF
CRAIG A. BERRINGTON
GENERAL COUNSEL
AMERICAN INSURANCE ASSOCIATION
BEFORE THE
SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE
JUNE 14, 1988

American
Insurance
Association

The American Insurance Association is a national
trade organization of casualty insurers.

PROFILE

The American Insurance Association is a full-service trade organization of casualty insurance companies. In its present form, the association combines three earlier organizations. One of those, the former National Board of Fire Underwriters, was organized in 1866, making it one of the oldest trade associations in the nation.

The various departments provide members with up-to-date intelligence—on legislative, regulatory, judicial and technical developments relating to our industry. The AIA also maintains liaison with insurance regulators, federal and state lawmakers, other state and federal government officials, insurance and non-insurance industry groups and media—supplying information and assistance on issues of mutual concern.

A countrywide system of regional offices and local legislative counsel ensures prompt and rigorous attention to casualty insurance matters. At the same time, technical specialists from disciplines as diverse as law, economics and engineering educate members and outside publics on developments that may affect the industry and its services to the insurance-buying public.

TESTIMONY
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JUNE 14, 1988

Thank you, Mr. Chairman. My name is Craig Berrington. I am General Counsel of the American Insurance Association (AIA). AIA represents major property and casualty insurance companies across the United States. I appreciate the opportunity to be here, today, to discuss the insurance antitrust litigation brought by the attorneys general of several states.

When the AG's first announced their lawsuits, they claimed that the suits held the key to the liability insurance crisis of the early to mid-1980's. In reality, the lawsuit is quite narrow and technical and primarily concerns three issues: (a) the development of a new commercial insurance policy called the claims-made form; (b) the continued availability and content of an existing commercial insurance policy called the occurrence form; and (c) a clause that excluded pollution coverage from those policies.

While the AIA is not a defendant in this litigation, we believe that the lawsuit raises important public policy questions about the role of state regulation of insurance, the true causes of the liability crisis, and the extent of competition in the insurance business. We can't litigate the case here, today -- and should not try -- but we can discuss these underlying issues in the context of the litigation. There are five points I would like to make.

FIRST, WHILE THE LAWSUIT ASSERTS THAT THE CLAIMS-MADE FORM WAS DEVELOPED IN VIOLATION OF THE ANTITRUST LAWS, THE FACT IS THAT THE CLAIMS-MADE FORM WAS DEVELOPED UNDER STATE INSURANCE LAW. It was debated publicly, at length, and was used only where approved by state insurance commissioners or subject to their disapproval. It is wholly inappropriate to now characterize that state-regulated process as violative of the antitrust laws and to place in jeopardy those who acted after receiving state approval.

SECOND, COOPERATIVE ACTIVITY TO DEVELOP INSURANCE POLICY FORMS SERVES THE PUBLIC INTEREST AND DOES NOT CONSTITUTE A "BOYCOTT" UNDER THE McCARRAN-FERGUSON ACT. The AG's misconstrue the debate over the claims-made and occurrence forms; they improperly apply the McCarran-Ferguson "boycott" language without regard to the regulated nature of the insurance business; and in the Texas lawsuit, the Attorney General is improperly utilizing the antitrust laws in an attempt to silence debate over tort reform.

THIRD, ALTHOUGH THE LAWSUIT ASSERTS THAT ILLEGAL INSURER ACTIVITY CAUSED THE REDUCTION OF POLLUTION INSURANCE AVAILABILITY, IT IS CLEAR THAT THIS AVAILABILITY PROBLEM WAS CAUSED BY BROAD JUDICIAL INTERPRETATION OF NARROW POLLUTION COVERAGE, NOT BY ANY "CONSPIRACY".

FOURTH, THE INSURANCE INDUSTRY IS HIGHLY COMPETITIVE. There are more than 3,500 property and casualty insurance companies, and none of them have a market share in excess of 8.6%. With such a dispersion of economic power, the industry is not structured in a way that encourages boycott or in which a boycott could succeed.

FIFTH, AND PERHAPS MOST IMPORTANT, THE CAUSES OF THE LIABILITY CRISIS LIE OUTSIDE BOTH THE ALLEGATIONS MADE BY THE AG's IN THEIR LAWSUIT, AND OUTSIDE THE ALLEGATIONS MADE BY THE AG's IN THEIR PUBLIC PRONOUNCEMENTS.

Mr. Chairman, I'd like now to discuss each of these points in greater depth.

I. DEVELOPMENT OF THE CLAIMS-MADE FORM FOR COMMERCIAL INSURANCE

The first issue I'd like to discuss is the development of the claims-made policy for commercial risks. The lawsuit asserts that there were antitrust violations in the development of the claims-made form by the Insurance Services Office ("ISO"). ISO is a state-regulated organization that develops rates and standardizes insurance forms. In performing those functions, ISO is charged, by state regulators, with obtaining the views of all interested parties on proposed forms, including insurers, reinsurers, customers, agents and brokers and the regulators themselves. The suit focuses on this process. Thus, the extent of state regulation over ISO and development of forms must be examined in order to evaluate the AG's'allegations.

A. State Insurance Law

Insurance has been extensively regulated by the states since the mid-1800's. More than 40 years ago, the primacy of state insurance regulation was reaffirmed by Congress when it swiftly enacted the McCarran-Ferguson Act in the wake of the Supreme Court's 1944 decision in United States v. South-Eastern Underwriters Association, 322 U.S. 533 (1944). Under McCarran-Ferguson, federal antitrust law is not to be applied in any state where that state has regulated the "business of insurance". McCarran-Ferguson provides, however, that "boycott, intimidation or coercion" are not exempt from federal antitrust enforcement, even if there is state insurance regulation.

The theory behind McCarran-Ferguson is that insurance is fundamentally different from other businesses because insurance requires the pricing of a product today based upon the prediction of costs in the future. Thus, collective activity to obtain data, analyze it and develop standard policy forms would promote more responsible pricing and, therefore, the public interest. The McCarran-Ferguson Act's legislative history amply demonstrates that the collective development of policy forms was one of the cooperative activities recognized by Congress as exempt from the antitrust laws. Further, the Supreme Court and lower courts have held that form standarization is protected under the Act. Further, the development of standard policy forms is the only way to collect comparable data.

Under McCarran-Ferguson the insurance code of every state--including the states of the AG plaintiffs--has authorized directly, or indirectly, cooperative activity to develop these forms. Thus, there is authority in Massachusetts (see Mass. Gen. Laws Ann. Ch. 175A, §§2, 8(d) (West 1987)), West Virginia (see W. Va. Code §§33-20-1, -6(d) (1988)), Alabama (see Ala. Code §27-13-1 (1986)), Arizona (see Ariz. Rev. Stat. Ann. §§20-341, -365 (1975)), Minnesota (see Minn. Stat. Ann. §70A.01(2)(d) (West 1986)), Wisconsin (see Wis. Stat. Ann. §625.01(2)(d) (West 1980)), Texas (see Rev. Civ. Stat. Ann. art. 5.19(c) (Vernon 1981)), New York (see N.Y. Ins. Law §§2301, 2313(o), 2316(c) (McKinney 1985)), and California (see Cal. Ins. Code §1853 (West 1972)).

The California code's language is particularly instructive. Under the California code insurers and insurer organizations, like

ISO, are not only permitted to establish joint forms, but the statute also specifically authorizes them to work with "insurers and others" to do so. (See Cal. Ins. Code §1853 (West 1972)). As I will discuss later, that is exactly what ISO did in developing the claims-made policy. It worked with "insurers and others" to develop that form -- activity which California's attorney general now wants to characterize as a violation of the antitrust laws.

In addition to authorizing collective activity in the development of policy forms, most state insurance codes specifically require that forms be filed and approved by the insurance commissioner. In every state, the insurance commissioner has the authority to prohibit, for good cause, the continued use of an insurance form.

Further, insurance commissioners are authorized to disapprove and enjoin any activity by an insurer or insurer organization that is unfair, deceptive, or discriminatory. It is clear, therefore, that the state insurance codes provide ample authority to have attacked and cured directly any problem that these AG's might believe exists. The AG's, however, have chosen not to use the direct route provided by the insurance codes; instead they have chosen to attack collaterally so insurers cannot defend themselves through the state regulatory process, which Congress said in the McCarran-Ferguson Act should supersede the federal antitrust laws.

B. The Claims-Made Form Development Process

In reviewing the history of the development of the claims-made form, it is important to understand that not only were these insurance codes on the books empowering insurance commissioners to oversee the development of the form, but that those powers were, in fact, exercised energetically and forcefully throughout the entire process.

1. Definition and use of Claims-Made and Occurrence Forms

Traditionally, commercial liability insurance has been sold using one of two types of policy forms: the occurrence form or the claims-made form. While there are many varieties of these forms, the distinction between the two is easy to describe. The basic occurrence form covers specified types of risks and will reimburse for bodily injury or property damages occurring within the time period of the policy, whenever those injuries or damages are reported even if that is years or decades later. The basic claims-made policy similarly specifies the types of risks it will cover, but will cover injury or damage whenever it occurred so long as claims are made during the period of the policy.

There are several situations in which a claims-made policy can offer an advantage over an occurence policy to both insurers and policyholders. First, there are circumstances in which it is difficult to pinpoint the timing of the injury or damage, the event that triggers coverage under an occurrence policy. For example, a physician, architect, attorney or other professional may repeatedly render services to one client over a period of time that spans several policy years. As another example, the past decade has witnessed the rise of a variety of "toxic torts" and other personal injury claims involving repeated or continuous exposure and long-latency diseases. The claims-made policy addresses this problem by making the filing of the claim, rather than the occurrence of injury or damage as the event that triggers coverage.

Second, claims-made policies offer an advantage in "long tail" liability lines, that is, lines in which losses are likely to be reported many years after the policy has expired. For example, the claims-made form has been used for many years for medical malpractice insurance because claims are often not made until years after the allegedly negligent medical procedure occurred. The reason for this claims-made preference is that all insurance pricing is based on a prediction of the likelihood and cost of claims. Predictions of the future are never perfect, in any case, and as you try to predict longer into the future, your ability to accurately predict diminishes. This problem is exacerbated when you cannot use current legal doctrine to make long-term predictions because of the unstable legal environment in which we live. Thus, when the legal environment started to destabilize for commercial liability, especially with regard to the liability of manufacturers for their products, interest developed in the possibility of utilizing a claims-made form for the provision of commercial liability insurance.

2. Industry Activity and Government Oversight

The Insurance Services Office (ISO) has responsibility for developing standard policy forms for much of the insurance industry. ISO is a state licensed and regulated organization in which insurance companies are members. In addition to developing policy forms, ISO has responsibility for seeking approval of them by the state insurance commissioners.

In 1982, after five years of research, ISO first circulated an "Exposure Draft" of a standard claims-made policy for commercial risks. The distribution was wide -- primary insurers, reinsurers, agents, insurance customers, academicians and lawyers -- and comprehensively reported and commented on in the insurance trade press. For example, there were reports in the *Journal of Commerce*, on October 4, 1982, and in the *Insurance Advocate*, on October 23, 1982. Over the next two years, input was obtained from many sources, including the views of state regulators.

In January, 1984, ISO formally announced the filing of two policies -- a claims-made policy and an occurrence policy -- and started the process of filing them with the state insurance commissioners. Once they were filed, they gained much more public attention; the discussions that had preceded the filings now became hot debate, with strong proponents and strong detractors of the claims-made form stating their views. Among the strongest proponents of the claims-made form were some of the London reinsurers. The National Underwriter magazine reported, August 2, 1985, that a Lloyd's reinsurance broker told a conference of insurance commissioners that "Lloyd's underwriters cannot be expected to continue to make contracts involving the existing occurrence-type policies because of the 'extraordinarily liberal interpretations' applied to the term 'occurrence' by American courts. He said it has become impossible for underwriters at Lloyd's to make an assessment of potential loss under current American liability rulings." [National Underwriter, Issue No. 31 (August 2, 1985) (p.1).]

Among the strongest opponents to the claims-made form were certain insurance agents, who expressed their opposition in numerous meetings with ISO and in public statements. Many commercial insurance purchasers also expressed their concern with the claims-made policy. And insurers, themselves, were split on the utility of the form -- whether it would work and whether customers would want to use it.

Because of the intense debate, hearings were held in many states, including Texas, Massachusetts, New York, and Minnesota. In addition, under the auspices of the Illinois Insurance

Commissioner, large public hearings were held in Chicago, in July 1985, where representatives from all points of view were closely questioned by a panel of 18 insurance regulators. This exercise of insurance commissioner authority was unprecedented. In the year following the debate, 48 states approved the revised occurrence form, and 44 states approved the claims-made form, many requiring modifications before approving. Only six states disapproved it, and of those six, three of them have joined this antitrust suit. In Minnesota, the claims-made issue was of such public importance that special legislation was enacted in 1986. Under that legislation, the insurance commissioner was only allowed to approve the claims-made policy form developed and filed by ISO. [Minn. Stat. Ann. §70A.08(3)(West, 1986).]

This is a picture of a regulatory system working as it should, with insurance commissioners closely overseeing the process and permitting only those claims-made policy forms to be used that they thought were consistent with the public interest.

II. THE MISUSE OF THE BOYCOTT PROHIBITION

The second issue that must be addressed is the question of "boycott, intimidation or coercion." The lawsuit alleges that those who said they would no longer use the occurrence form for primary insurance or accept that form as a basis for writing reinsurance were illegally engaging in a boycott of the occurrence form or, alternatively, coercing and intimidating others to abandon the occurrence form and use a new claims-made form. Even taking the AG's allegations at face value, the mere recitation of the McCarran Act "buzz words" "boycott, coercion, or intimidation" does not render the Act inapplicable. The allegations must fit within the Supreme Court's narrow definition of the term "boycott" for McCarran Act purposes. When the Supreme Court's definition is applied to the allegations in the AG's complaints, major deficiencies become readily apparent.

A. Agreements concerning the terms of policy coverage and decisions not to issue a particular policy form do not constitute a boycott under the McCarran Act.

Supreme Court and federal case law, as well as the legislative history of the McCarran-Ferguson Act amply demonstrate that an agreement concerning the terms of policy coverage and decisions not to issue a particular policy form do not constitute an illegal boycott. The Supreme Court first addressed the meaning of the term "boycott" in St. Paul Fire & Marine Ins. Co. v. Barry, 439 U.S. 531 (1978). It defined "boycott" as a concerted refusal to deal on any terms. Id. at 541-42. "Boycott" does not include decisions by insurers on what terms of coverage they will offer, or what terms will be placed in the standard form policy. In analyzing the facts in Barry, the Court clearly distinguished between absolute refusals to deal and agreements establishing rates or terms of coverage. Id. at 544-45, 548, 553. Responding to antitrust allegations reminiscent of the federal and Texas lawsuits, the federal district court in UNR Industries, Inc. v. Continental Ins. Co., 607 F. Supp. 855 (N.D. Ill. 1984), motion den. 623 F. Supp. 1319 (N.D. Ill. 1985) has recently held that allegations of an agreement among insurers to market a new claims-made policy failed to state a federal antitrust claim. In dismissing this antitrust count, the court, citing Barry, stated: "[A]n agreement to change to a new type of policy is not a boycott and does not constitute coercion or intimidation. . . ." 607 F. Supp at 862.

The legislative history of the McCarran-Ferguson Act further supports the view that agreements concerning terms of coverage do not constitute a boycott. In Group Life & Health Ins. Co. v. Royal Drug Co., 440 U.S. 205 (1979), the Supreme Court, reviewing the legislative history of the McCarran-Ferguson Act, emphasized that the drafters of the legislation intended to exempt from antitrust attack certain cooperative activities regarding insurance, including the development of policy forms. Id. at 221-24

Thus, the AG's are obviously straining to transform into a "boycott" the legitimate, state-sanctioned decisions by insurers on the terms of coverage included in an insurance policy form. Neither the facts nor the law support that attempt. What the AG's are really doing is misusing the "boycott" exception to attack the legitimacy of state insurance regulation.

B. Because the development of policy forms occurs pursuant to comprehensive state regulation under the McCarran-Ferguson Act, the challenged activities may not be attacked under the antitrust laws.

As we have already discussed, insurance policy forms are developed pursuant to carefully crafted systems of state law which provide for extensive control by state insurance commissioners. The lawsuit, however, appears to assume that the existence of this regulated insurance system is irrelevant to determining whether antitrust violations have occurred. This underlying assumption is wrong.

The Supreme Court has long been sensitive to the need to carefully reconcile the general language of the antitrust laws with the detailed regulatory systems established under other statutes. The Court has wanted to be certain that, among other factors, the general antitrust laws are not used to undermine the specific purposes of regulatory law. Indeed, in recent years, this concern has been increasingly clear in Court decisions. Thus, for example, in *Gordon v. New York Stock Exchange, Inc.*, 422 U.S. 659 (1975), the Supreme Court held in a case arising under the securities laws that "rate fixing" by members of securities exchanges was absolutely immune from antitrust attack under the Sherman Act because "rate fixing" was adequately regulated under the comprehensive regulatory system of the Securities and Exchange Act.

I think it is fair to say that if an activity such as mandatory "rate fixing" were absolutely immune from Sherman Act attack because it was done within a regulatory structure, then the development of voluntary insurance policy forms under insurance commissioner oversight must, *a fortiori*, also be immune to Sherman Act attack. Any other outcome would effectively repeal the state insurance regulatory laws expressly authorized by McCarran-Ferguson, and thus place in doubt the legality of every cooperative activity undertaken pursuant to state insurance law. The state insurance codes would, in important areas, be effectively nullified because every act undertaken pursuant to them, even with insurance commissioner approval, would be subject to antitrust attack. Insurers would be placed in the impossible position of having to respond to "duplicative and inconsistent standards." United States v. National Association of Securities Dealers, 422 U.S. 694,735 (1975).

C. Since the authority to develop insurance policy forms collectively is one of the primary purposes of McCarran-Ferguson, the McCarran-Ferguson "boycott" provisions cannot be used to circumvent that authority.

The lawsuit asserts that activity relating to the development of the claims-made form and to the use of the occurrence form constituted a violation of the McCarran-Ferguson prohibitions on "boycott, intimidation and coercion." It is "hornbook" law that the various provisions of a statute must be read together to provide a rational reading of the entire statute, and that the general language of one provision should not be read to undermine a specific purposes of the law. Yet that is exactly the approach in this lawsuit -- to use the general "boycott" provision to eviscerate, if not eliminate, the specific purpose of McCarran-Ferguson, to allow the collective establishment of policy forms. This point was made well in a 1983 William and Mary Law Review article by Alan M. Anderson, which said:

> Congress clearly intended to allow insurers to establish policies on a collective basis, as long as the states regulated such activity. Courts, therefore, should heed the legislative intent and not allow the public to challenge policymaking activity under the boycott exception.
>
> Anderson, Insurance and Antitrust Law: The McCarran-Ferguson Act and Beyond, 25 Wm. & Mary L. Rev. 81, 106-07 (1983) (footnote omitted).

Thus, Mr. Anderson states that the "boycott" exception should not be used to subvert McCarran-Ferguson's grant of authority to develop policy forms collectively, as long as that activity is regulated. Here, as we have already shown, not only was this activity regulated on paper, it was regulated in fact through the oversight of state insurance commissioners.

D. Uniquely among the suits filed, the Texas suit claims that the defendants violated the antitrust laws by advocating changes in the Texas tort system. The claim is wrong and endangers our constitutional rights of free speech and to petition the government.

The Texas lawsuit alleges that the defendants violated state antitrust law by banding together to urge changes in the civil justice system -- changes that Attorney General Mattox strongly opposed. Specifically, the Texas complaint alleges that in 1986 the defendants shifted their emphasis from so-called rate and policy reform and conspired to boycott particular insurance lines, providers, and insurance consumers to create the "necessary crisis atmosphere to promote tort reform" and to increase the pressure on regulators to approve the new claims-made form and on legislators to change the civil justice system. The only evidence of this "plot" recited in the suit are various public statements by prominent insurance executives calling for industry and national public support of tort reform initiatives and the Insurance Information Institute's national advertising campaign regarding the liability crisis.

Examination of what actually occurred in Texas simply does not support Mr. Mattox's version of the facts. Events in Texas, which culminated in the 1987 enactment of both insurance regulation and some civil justice reforms, were not dissimilar from what transpired in many other states. The fight for tort reform in Texas was led, not by insurers, but by the Texas business community. And the package of insurance regulation and tort reform that became law in 1987 was based, in large part, on the findings of the Texas House-Senate Joint Committee on Liability Insurance and Tort Law.

Perhaps disappointed by the legislature's decisions, Attorney General Mattox has now filed a lawsuit against the proponents of tort reform, claiming that their advocacy amounted to a boycott. But this allegation is wrong. There is an absolute constitutional right to make advocacy statements and for competitors to join together to advocate changes in the law. Two Supreme Court cases, Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc., 365 U.S. 127, rehearing denied, 365 U.S. 875 (1961), and United Mine Workers v. Pennington, 381 U.S. 657 (1965), established the general rule that no violation of federal antitrust laws can be predicated on lobbying and other similar concerted political activity by businesses to obtain legislative or executive action. The Noerr-Pennington doctrine has also been recognized and applied in Texas pursuant to Diaz v. Southwest Wheel, Inc., 736 S.W.2d 770, 774 (Tex. Ct. App. 1987).

The underlying rationale of Noerr-Pennington is that the Sherman Act, and analogously the Texas Antitrust Act, should not disqualify people from taking a public position on matters in which they have a financial stake and thereby deprive the government of a valuable source of information. Individuals may not be denied their right to petition the government about issues that may be of the utmost importance to them. Of course, Noerr-Pennington protection has not been afforded to efforts to influence administrative and judicial proceedings when that activity was a "sham" to conceal anticompetitive conduct, but "tort reform" was a legitimate legislative issue and was certainly not a "sham." This was a broadly-based good faith effort to get changes in state law.

Thus, the Texas claim appears to us to be essentially an effort to silence advocates of Texas tort reform and, therefore, raises unsettling questions about the proper use of governmental power. Under the guise of enforcing antitrust laws, public officials are not entitled to harass and intimidate individuals engaging in legitimate political activity simply because these officials disagree with the opposition's view on important policy issues.

III. REMOVAL OF THE POLLUTION EXCLUSION AND AVAILABILITY OF POLLUTION INSURANCE

The third area I would like to discuss relates to the availability of pollution insurance. As I noted earlier, the complaint alleges that a conspiracy of the defendants caused the availability of pollution coverage to be eliminated or drastically reduced. I read this part of the lawsuit with utter disbelief. While the other public policy allegations of the lawsuit appear factually incorrect and legally unsupportable, the pollution allegation is, I believe, beyond the comprehension of everyone knowledgeable about the insurance market for environmental risks. Those who have studied the issue appreciate why pollution coverage was eliminated from the standard commercial insurance policy.

Pollution liability insurance has always been a specialty market. The ISO standard form policy for commercial insurance had a pollution exclusion dating back to 1970. That exclusion was subject to the one exception for "sudden and accidental" pollution. If the discharge of contaminate was both "sudden" and "accidental," the policy would respond.

Insurers intended that the word "sudden" in the pollution exclusion be understood by its ordinary dictionary definition. As exemplified by the now notorious Jackson Township case, Jackson Twshp. Mun. Util. Auth. v. Hartford Accident and Indem., 451 A.2d 990 (N.J. Super. Ct. Law Div. 1982), courts have often ignored this definition of the term "sudden" and have ruled that the pollution exclusion clause does not bar coverage for incidents which developed over a long period of time (in some instances decades). They have reached their conclusion by interpreting "sudden" as "unintended and unexpected," thus rendering it synonymous with "accidental." Subsequent to Jackson Township, state and federal courts have interpreted the pollution exclusion in dozens of cases without developing a clear trend as to its intended meaning. Thus, insurers could no longer rely on an appropriate and predictable interpretation of this policy language.

Therefore, the elimination of the pollution exclusion in the commercial general liability policy was not an effort to either restrain trade or increase the price of pollution liability coverage. It was a necessary and inevitable reaction to court decisions which interpreted the disputes between insurers and policyholders involving the exclusion as a way to locate additional financial resources to address environmental problems in the United States. By removing all pollution exposure from the commercial policy, insurers were able to continue to make general commercial coverage available to the vast majority of this nation's businesses.

At the same time pollution coverage, whether nonsudden or sudden and accidental, continued to be covered by one pollution liability policy soley covering pollution risks. By placing all pollution exposure in a single policy, insurers eliminated the possibility of judicial misinterpretation of contract language which created an unintended exposure for which no premium was collected.

IV. COMPETITION IN THE PROPERTY AND CASUALTY INSURANCE INDUSTRY

My fourth point is that contrary to the AG's assertions, property and casualty insurers are highly competitive. The allegations made in the AG's lawsuit and their public pronouncements about the cause of the tort liability crisis share a common premise: that the property and casualty insurance industry is not competitive in its structure or performance. Because of this alleged noncompetitiveness, insurers have colluded to raise prices to unreasonably high levels, plotted to create the liability crisis and allocated their economic resources pursuant to conspiracy rather than the forces of competition. This premise is false. By every standard measure of market structure and market performance, the insurance industry is highly competitive. Every disinterested or neutral party, including governmental task forces and experts in economics, business, and antitrust law, that has examined the charges has reached the same conclusion, dismissing the conspiracy theory.

A. Market Structure in the Insurance Industry is one of Very Low Concentration and Very High Competition

The two measures that are commonly used to characterize market structure and to determine the potential for noncompetitive behavior are concentration of market share and the ease of entry into and exit from the market. Of these two measures, concentration of market share is the primary factor generally considered in assessing market structure.

High concentration facilitates collusive agreements because it is easier for a few dominant firms to agree to specified terms than it is for many firms in a less concentrated market to do so. In addition, it is easier to police and maintain adherence to an agreement when only a few firms are involved.

However, if one examines the concentration of market share in the property and casualty insurance industry one finds that the level of concentration is quite low. There are over thirty five hundred property and casualty companies operating in the United States, and none of them have a market share in excess of 8.6%. With respect to commercial liability insurance (the kind of insurance at issue in the litigation), our research shows that the top four companies hold approximately 25% of the market, less than half the 60% concentration that represents the upper limit of a competitive market (a standard economic measure of market competitiveness). Similarly, the top eight insurance companies hold only 40% of the market share, again only half the 80% concentration that represents the upper limit of a competitive market. When the assets of the top ten insurers in 1984 are compared with the top ten commercial banks and securities underwriters, the market concentration of insurers was nearly identical to banks and about one-half of securities underwriters.

A second standard measure of market concentration is the Herfindahl-Hirshman--or HH--Index. Under the HH Index the entire market is measured, rather than simply the largest firms. The Department of Justice considers a market with an Index value of below one thousand to be unconcentrated. If the Index value is above eighteen hundred, it considers a market to be concentrated.

The HH Index for commercial liability insurance (1985) ranges from 286 (Commercial Multiperil) to 330 (Other Liability). Each figure is at least three times below the Index value of 1000 that is considered the upper limit of a competitive market. Compare the insurance industry figures to other industries and you begin to get a feel for just how low the insurance industry's HH Index value is. Steel has an Index of 650; primary aluminum, 1704; farm machinery, 1468; household cooking equipment, 1914; phonograph records and tapes, 1153, and motor vehicle parts and accessories, 1817.

Thus, market share analysis concludes that the property and casualty insurance industry is exceedingly competitive. The other measure of market structure, the examination of entry and exit barriers, confirms that conclusion.

Entry into the property/casualty insurance market is relatively easy. Although minimum capital requirements vary by state, they are generally under $2 million dollars. Unlike many other industries, fixed asset requirements are low, consisting primarily of home office, branch office, and computer facilities. These can be bought, leased, or rented on short notice. Insurance expertise, such as actuarial and loss adjustment services, can be contracted out to consulting firms if it proves difficult to hire the requisite workforce.

Moreover, for existing insurance companies that wish to expand into new marketing areas within a state, different states, or insurance lines, these requirements are even less of a barrier. Companies expanding within a state already have a license to operate. Home and branch office and computer facilities are available without additional fixed expense. Expansion into new states with new lines of insurance is generally only slightly more difficult than expansion into a new area within a state.

Apart from the number of insurance firms entering and exiting insurance markets, the growth of the self-insurance market is another manifestation of the lack of entry barriers in insurance markets. Captives, risk retention groups, and other forms of self-insurance have taken a growing share of commercial insurance markets. Minimum capital requirements are low, particularly for off shore captives. Insurance management and administration of these entities is readily available and eagerly sought by insurance brokers and companies.

Because of the ease of entering insurance markets, entry by self-insurance mechanisms often reflects the insurance cycle, adding another competitive element in all commercial lines. From an estimated seven hundred million dollars in 1970, premiums for self insurance groups, captives, and risk retention groups have grown to an estimated thirty-eight billion dollars in 1986, about 28% of the total commercial lines market.

In order for noncompetitive practices to be possible, Mr. Chairman, the market structure must have *both* high concentration of market share and significant entry-exit barriers. The property/casualty insurance industry, however, possesses *neither* concentration of market shares nor entry-exit barriers. Thus, market structure analysis reveals that the industry is quite competitive.

Let's now examine market performance measures.

B. Market Performance Tests also Demonstrate High Competitiveness and Cyclical Profits in the Insurance Market

Market performance tests measure the change in market share of the leading companies. Formal or informal agreements among firms to eliminate price competition lead to stable market shares, and therefore, stable market share ranking over time. Changes in ranking, on the other hand, indicate that companies have competed through pricing and other marketing strategies and that some companies were more successful than others in their efforts. Thus, one test to determine whether companies have competed is to measure changes in ranking of the leading firms in each insurance market between two time periods.

AIA recently examined changes in market share by looking at changes in ranking among the ten leading writers (in terms of premium volume) in each of seven insurance lines in twelve sample states chosen at random. We found that there were very significant changes in market shares, the kinds of consistent, significant changes that document the competitive performance of the insurance industry.

In 97% of the lines of business that we examined, there were four or more changes in ranking among the top ten writers during the years covered by the study. Moreover, in 70% of the lines of business, there were seven or more changes among the top ten writers. Finally, several companies not included among the top ten at the beginning of the study entered the top ten in most lines in most states by the conclusion of the study.

Economists use changes in market share as one indicator of competitive performance. By this standard, one can only conclude that insurance company behavior is quite competitive.

Competition is also reflected by the fact that profits in the industry, although cyclical, are on the average below that of other industries. Collusive activity should generate high and stable profitability over a period of time. Conversely, the lack of high profitability or stability of profits indicates that collusive activity does not exist or, if attempts are made to collude, they are not effective because the underlying structure of the market is competitive. For example, from 1970 to 1985, a period that encompassed two complete underwriting cycles, the average return on net worth was 10.1% for the property/casualty insurance industry, compared to 11.8% for the group of noninsurance industries. The insurance industry fell within the bottom third of profitability ranking of all-industries. Moreover, insurance industry profitability, either alone or in comparison to the industry grouping, shows considerable variability over this fifteen year period. During down-cycle phases, 1974-1975 and 1981-1985, insurers recorded much lower profitability. During up-cycle phases 1970-1973 and 1976-1980, insurers showed only slightly higher profitability. Thus, profits have been neither stable nor excessive in the insurance industry.

To appreciate the competitive nature of the business, one merely needs to browse through any of the insurance trade magazines to see the concrete everyday results of this intense competition to increase, or retain market share. For example, consider the May 16, 1988 edition of Business Insurance, which has an article entitled "State Of The Market--Competition Heats Up For Renewals." The article quotes risk managers, brokers, and insurers who confirm that buyers renewing their property/casualty programs this spring are seeing great coverage availability, better terms and conditions and/or rate reductions of anywhere from 10% to 40% on most lines of property/casualty business. The reason is competition -- competition being driven by insurers. This article also conveys another important message aside from the fact that the industry is competitive. Various individual companies are named accompanied by summaries of their individual approaches to retaining or increasing their market share. What one sees, not surprisingly, is that each company has a different strategy, different priorities, and different areas of emphasis. This is the very essence of competition in action. It is revealed, not merely in economic theory, but in the day-to-day reality of the business world.

V. THE REAL CAUSES OF THE LIABILITY CRISIS

Mr. Chairman, we have now seen that the insurance industry is highly competitive as measured by all of the standard economic indicators. Given this competition, the notion that insurers conspired to create the liability insurance crisis of 1984-1986 is untenable at best and, indeed, has been rejected by economists, antitrust experts, and government regulators. Here's a sample of those findings:

- "One significant problem with the collusion hypothesis is that the commercial liability insurance market is competitively structured." [Harrington and Litan, "Causes of the Liability Crisis", Science (February 12, 1988).]

- "No one brought to our attention, nor did our analysis reveal, evidence of noncompetitive actions by insurers to raise prices in commercial liability insurance or to refuse to write new insurance." [Virginia State Corporation Commission Bureau of Insurance, Report on the Level of Competition, Availability, and Affordability in the Commercial Liability Insurance Industry (November 1987).]

- "Economic assessment indicates that . . . collusion among insurers . . . is highly unlikely to have caused the crisis." [U.S. Department of Justice, An Update on the Liability Crisis (March 1987).]

- "We have encountered no evidence to support any assertion that an industry conspiracy or collective manipulation has occurred, and there are strong theoretical and practical reasons to suggest that it did not." [New York Governor's Advisory Commission on Insurance, Insuring Our Future (April 1986).]

- "Collusion cannot explain why the basic insurance policy has been restructured." [Priest, "The Current Insurance Crisis and Modern Tort Law", 96 Yale L. J. 1521, 1528 (1987).]

- "In sum, the collusion hypothesis is not persuasive. The structure in recent history of the commercial liability insurance market reveals no evidence of a cartel. The fact that the industry was profitable in 1986 says little about whether premiums for that year will ultimately prove to have been excessive; and although the industry acted as one in supporting tort reform, this collective behavior is equally open to noncollusive explanations based on the individual interest of each company. In short, collusion as an explanation for the insurance crisis is implausible in theory and unlikely in

> practice. The hypothesis falls not only because the arguments for it are weak, but also because the alternative explanation for the crisis--the combination of the surge in tort costs and the predictability problem is persuasive." [Manhattan Institute For Policy Research: Project on Civil Justice Reform No. 7, referencing Abraham's, New Directions in Liability Law.]

While the conspiracy theory, as a general concept, is without merit for a hihgly competitive industry like insurance, the particular conspiracy alleged by the AG's, as stated in their complaints, is inconsistent with a simple reading of the chronology of events. The first reports of distress in some of the more volatile classes of liability insurance began in 1984. The so-called liability crisis was being widely reported in the media by 1985, cresting in late 1985 and early 1986. The commercial general liability forms at issue in the litigation were not approved for use, in those states that have approved them, until early 1986, just at or after the peak of the crisis. During 1984 and 1985, the heart of the crisis, the forms were nothing more than a proposal, a proposal generating extensive discussion as to the provisions of the forms that insurers should be permitted to use in the future.

The fact is that terms and conditions of coverage during the liability crisis were negotiated based on ISO forms that had already been approved by state regulators back in 1973. The concomitant discussion over the provisions of forms that may or may not be approved at some time in the future did not and could not have contributed to the crisis.

If the industry did not create the liability crisis, then what did? Several factors need to be considered. The liability insurance crisis of the mid-1980's occurred at the nadir of an insurance cycle. This particular cycle was unprecedented in its duration and severity. The reason for this unprecedented severity is clear: the naturally cyclical tendency of the industry was severely exacerbated by extraordinary conditions in the economy, generally, and, in addition, by the expansion of tort liability over the previous decade. Let's take a closer look at each of these two components of the liability crisis: the insurance cycle and the expansion of tort liability.

Historically, the supply of the insurance product--in terms of both its availability and its affordability -- has been subject to cyclical fluctuation. The causes of the cycle have been examined in numerous journals, papers, and studies. The relationship between specific factors causing the swings of any particular cycle are probably unique. However certain generalizations can be made.

First, the insurance underwriting cycle is partially a reflection of, indeed an inseparable part of, the business cycle that characterizes a free market economy. The money supply, the exchange rate with respect to foreign currencies, interest rates, the imperfect match between demand and supply, and other factors combine to produce business cycles. No industry is immune from the effects of the business cycle. Housing, steel, manufacturing, and financial services are all affected by it. So is insurance. It is simply unreasonable to expect otherwise.

During the late 1970's and early 1980's, our nation's economy was in trouble. Growth and productivity were stagnant and inflation, at times reaching double digits, was higher than it had been since the Civil War. With inflation and interest rates at record heights, the price of goods and services soared. The price of one product, however, remained stable, and even decreased, during this entire time frame: liability insurance.

This period of stable insurance pricing resulted from the effects of insurers lowering premiums to reflect high earnings on interest rate sensitive earnings and from intense competition for market share. The ability of insurers to invest premium dollars at high interest rates, coupled with the always intense drive to retain and expand market share, enabled individual insurers to cut prices at a time when other prices were rising. In fact, consider what would have happened had insurers not passed along the "benefits" of inflation to their customers. Their pricing practices would have been questioned in the regulatory arena and those now accusing insurers of boycott would no doubt have been decrying what would have been record profits.

But, instead of realizing record profits during the early 1980s, the property/casualty insurance industry realized recordunderwriting losses. Even after investment income and capital gains are accounted for, the results for those years were abysmal. Return on net worth, a standard measure of corporate profitability was 1.8% in 1984 for the property/casualty insurance industry. This compares to 13.5% return on net worth for the Fortune 500 Industrials for the same year. In 1985, the insurance industry did not fare much better: return on net worth for that year was 3.8%.

The reason for these poor results is clear. The natural cyclical tendency of the industry was exacerbated by a decade-long expansion of tort liability. At a time when premium volume remained constant, due largely to competitive forces and the impact of the trough in the nation's business cycle, losses increased substantially. Moreover, insurers began to lose confidence in the ability to predict the frequency or severity of future losses in certain classes of risks. Much of this uncertainty came from changes in the tort system.

Whether or not the expansion of tort liability has had a positive or negative impact on American society has been hotly debated. For present purposes, the important point is the incontrovertible fact that such expansion has taken place. Perhaps with noble intentions to "do justice" in individual cases, courts have chipped away, or thrown away, a variety of common law concepts that had historically served as significant underpinnings of tort law. These concepts had also been traditionally relied upon by insurers in selecting and pricing the coverages they had written.

Examples of this erosion of common law concepts are so numerous that compiling an exhaustive list is difficult. Some of the more prominent examples include: the decline of negligence or fault as the basis for imposing liability, and the substitution of various forms of strict or absolute liability; imposition of various forms of retroactive liability, of which the weakening of the "state of the art" defense and the superfund statute serve as examples; increasingly frequent use of the doctrine of "joint and several" liability, expanding it beyond the bounds of its origins; weakening of the traditional concept of causation in terms of both medical or scientific testimony and the rise of various alternative theories such as market share or enterprise liability (when the identity of an actor cannot be established); the rise of the discovery rule with respect to statutes of limitations; the allowance of recovery by plaintiffs exposed to danger before they have suffered any tangible physical harm; allowance of recovery for emotional harm for witnessing physical harm done to another; and the abandonment of contributory negligence as a defense.

This rapid expansion of liability principles has had a dual impact on insurers and insureds. First, simply put, tort loss payouts have increased dramatically. This fact has been reconfirmed as recently as this month, with publication by the Brookings Institution of its study, Liability: Perspectives And Policy written by top economists, lawyers, and scholars. The study concludes that tort doctrines have indeed been liberalized so that liability is broader, standards of contributory negligence and proof of fault have been relaxed, and statutes of limitations have been extended. Moreover, based on available data, the study concludes that average awards in tort cases have increased faster than real GNP growth. These findings confirm the conclusions others have reached, including the Rand Corporation's Institute for Civil Justice.

Concomitant with this increase in paid losses was the decline in predictability with respect to future losses. Insurers have substantially diminished confidence that they, or anyone else, can predict which legal doctrine will be the next to fall in a given state, the rate at which the new doctrine will spread from state to state, and the effect each of the foregoing will have on claim frequency and claim severity. The decline of predictability, as might be expected, has had its most dramatic effect on long-term liability lines.

Faced with record underwriting losses and eventually, falling rates, it was clear that prices would rise and that insurers would be hesitant to allocate their limited capacity to the more volatile, long-tail lines. This was no conspiracy. It simply proves what should be self-evident: that insurance mirrors the economy in which it operates and the liability system it underwrites.

Thank you, Mr. Chairman.

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Senator **Metzenbaum**. Thank you, Mr. Berrington.

I assure you no legislative action will be based solely related to this lawsuit. I thought that we ought to go forward with the legislation long before the lawsuit was filed, and I still think so.

Let me make a comment to you. Your narrow interpretation of the McCarran boycott provision is the best argument that I have heard in months for repeal of the exemption. Under your interpretation, an international conspiracy to shrink coverage and jack up rates is not a boycott and thus is immune from Federal antitrust challenge.

It is preposterous that a conspiracy of this kind, much less outright price-fixing and other anticompetitive practices, might be legal. There is only one solution to this situation, and that seems to me to be outright repeal of the exemption.

As I understand your contention, your response, it relates to the McCarran-Ferguson Act's existence as to part of the basis for the legitimacy and the propriety of the actions about which the attorneys general have complained.

Mr. **Berrington**. Mr. Metzenbaum, first of all, conspiracy is a legal conclusion, it is not a statement of fact. I believe that the facts will come out in the litigation, and the court will decide whether or not there was a conspiracy.

The fact is that the insurance industry was trying desperately to figure out a way to save the commercial liability insurance market in a situation where, for reasons such as the problems in the courts with regard to pollution coverage, it was difficult if not impossible to predict what costs were going to be.

You cannot sell insurance at a responsible price unless you can predict with some measure of accuracy what the claims are likely to be. When the pollution provisions became unpredictable because of court decisions, something had to be done.

And Mr. Chairman, any State in the Union can decide right now that it is not in the public interest of that State to allow collective activity to develop policy forms. Ohio, any State, could do that right now if the State thought that it was not in the public interest to develop policy forms in a collective way. But they have decided not to do that because they believe the public interest is served. And I think most everybody who researches the industry agrees.

Senator **Metzenbaum**. Well, Mr. Berrington, I think one of the basic concerns that is being expressed by some of us in Congress who think there ought to be repeal is that the insurance commissioners of this country, with some exceptions—and they are notable, because you can pick them out—have been pretty much under the domination of the insurance industry. As a matter of fact, many of the insurance commissioners have come from the insurance industry to become insurance commissioners, and so many that it is unlimited in number, so many insurance commissioners have gone from the commissioner position into the industry. And I think I will ask my staff to prepare a list of some factual data with respect to that, and it will be included in the record at this point, because I know as I have looked at the matter, I have just been overwhelmed at the close tie-in between these persons who have a responsibility to regulate, but instead of providing adequate regulation for the consumers and the public, have so often become part and parcel of the insurance industry either before or after meeting their public responsibilities.

Mr. **Berrington**. Mr. Chairman, those of us in the industry who deal adversarially with insurance commissioners every day would take a different view of that. And I think it is rather extraordinary to have litigation on forms after the insurance commissioners were actively involved across the country in forcing changes in those forms. For example Mr. Simon's insurance commissioner in Illinois, Mr. Washburn, convened a huge conference of 18 insurance regulators; they grilled reinsurers, grilled insurers, grilled customers, forced changes. This was active supervision, active insurance regulation. And I think an ad hominem comment about whether or not insurance commissioners are doing the job is just not fair.

What we know about in this case is that the insurance commissioners were all over the issue, all over the issue, and it was widely known in the press.

Senator **Metzenbaum**. Let me ask you one last question, and then I will turn to Senator Simon. Can you tell me at this point, or if you can't tell me at this point, can you provide us with, the net overseas premiums that are going from the insurance industry to the reinsurers overseas?

Mr. **Berrington**. Well, I don't have figures on that, but I think the important thing to understand is not in terms of premium going overseas; it is a question of the capital in the rest of the world being made available to provide sufficient insurance for risks in the United States.

Senator **Metzenbaum**. You don't think there is adequate capital in the United States to do that?

Mr. **Berrington**. I think that if there was adequate capital in the United States to do it, then the capital would be raised here. Capital, Mr. Chairman, for reinsurance comes from all over the world, and a lot of it benefits us. I think we need to be very careful before we do things that would, in effect, restrict it, because primary insurers can only provide large amounts of insurance if there are large amounts of reinsurance available. And primary insurers seek that reinsurance capital around the world. Those people who have capital around the world are not required to invest in American insurance risks; they do it only because they believe that there is a possibility of a reasonable return and that they will be investing in a country where there is a stable legal system and a stable economy.

Senator **Metzenbaum**. Can you provide us with the information I have just asked for?

Mr. **Berrington**. I will seek to get that information.

Senator **Metzenbaum**. And if you can as well, can you provide us with the net worth of the American insurance industry as compared to the net worth of the reinsurers who are providing that capital that you claim is so needed in order to provide a stable reinsurance industry?

Mr. **Berrington**. Do you mean the reinsurers around the world?

Senator **Metzenbaum**. Yes.

Mr. **Berrington**. That will not be easy. There are countries which are, themselves, reinsurers, some of which don't readily make their finances available to the public, let alone the United

States. I'll get what information we can for you with regard to reinsurance statistics and the insurance industry.

Senator **Metzenbaum**. Fine.

Senator Simon.

Senator **Simon**. Mr. Berrington, you heard and have seen the group of reinsurers who got together and said, "Let's not reinsure for pollution." Does that offend you?

Mr. **Berrington**. Well, I have not seen the document. Frankly, it wasn't shown to me. But let me make a couple comments on it, if I might. The document, I believe, is a market agreement by London-based reinsurers and others, and they are operating under British law. Market agreements are standard under British law with regard to the reinsurance market.

The London reinsurers basically act as joint venturers. They decide if they are going to get together to provide capital to reinsure a particular risk. They make decisions every day, to do it and not to do it. And if they don't do it, under British law, that is perfectly proper.

As to the public policy implication—and that is what I think is important to address here—the public policy agreement of a 1987 document with regard to the availability of pollution insurance, the public policy implications are almost nil. Pollution insurance, Senator Simon, as a part of the overall commercial liability policy, was dead in 1982, 1983, 1984, because of court decisions—as I mentioned a little bit earlier—court decisions which broadly interpreted very narrow contract language that only provided that pollution would be covered if the pollution event was sudden and accidental.

A decision in 1984, the *Jackson Township* decision, decided that the term "sudden" included seepage over 20 years. The industry then was faced with a situation—because other courts went the same way—where they had no way to predict losses. So that policy form—again under State insurance commissioner control—had to be changed if commercial liability insurance was going to be available for anyone. But at the same time that that form was changed to remove the very limited pollution coverage, another form, strictly for pollution coverage, was available. So there was never any lack of availability of insurance policy forms to provide for pollution coverage.

Senator **Simon**. But if—and I don't know anything about pollution insurance—if that document is so meaningless, as you are suggesting, why did 40 companies get together and decide they had to do that?

Mr. **Berrington**. Well, again, I've not had a chance to read it. These all look like London reinsurers, and they make decisions every day as to the type of reinsurance they want to provide.

Again, reinsurance capital can come from around the world, and primary insurers do not control the reinsurance which is available around the world. If there are those who believe that a reasonable underwriting profit can be made because it is reasonable to predict the losses that will occur, then the insurance will be written, for pollution or for anything else.

Senator **Simon**. Let me shift to another area, and that is the State insurance commissioners. So far as I know, John Washburn in Illinois is doing an excellent job. But there is no question that back some years ago in Illinois, the insurance commissioner was under the control of the insurance industry. At least, that was just commonly accepted by everyone.

Mr. **Berrington**. Yes.

Senator **Simon**. But let's just assume that all 50 insurance commissioners are diligent, have some hopes of going into the insurance industry for jobs, as Senator Metzenbaum has talked about—let's just say they are pure as the driven snow. How, when you are insurance commissioner of Wyoming, how can you keep on top of this vast industry and have adequate information?

Mr. **Berrington**. You raise, I think, two very good questions. One goes to the regulatory State generally, and the other goes to the way that the insurance commissioner of a State with a small population can handle regulation.

I think the first, which goes to the regulatory State generally, is a problem that you have in the Federal Government as well as in the State Government: How do you get people to take positions as regulators who know enough about the industry they are regulating that they can do a good job and at the same time not have had experience in that industry and, at some time in the future, go back to it?

I was in the Federal Government for 18 years, Senator, as a regulator most of those years, and I know that's a problem. I don't think there is a perfect answer to it. You just have to be very careful about who you pick.

I can tell you that in my experience, the insurance commissioners are very, very tough. Now, how does an insurance commissioner in Wyoming do it? Well, he does it in several ways. First of all, there is a National Association of Insurance Commissioners, which is the focal point of providing statistics, providing staff, providing model laws. That helps a lot.

Secondly, they do as State attorneys general do—there are lead States, and those lead States are looked to. One very strong advantage, one great advantage of having a State insurance commissioner, is that he can deal with local problems.

It was interesting this morning that the Attorney General from Massachusetts, Mr. Shannon, talked about the problem of the availability of child care and that that was a problem in the market in Massachusetts. The fact is that the Massachusetts insurance commissioner under the McCarran Act—and he couldn't do this if the McCarran Act were repealed—can bring companies together and say okay, we're going to figure out a way to get insurance to reasonable risks in child care. The Wyoming insurance commissioner can do the same thing and use the resources available in his State and in the National Association of Insurance Commissioners and with other insurance commissioners to do it.

Senator **Simon**. I'm not at all sure that you're correct that they couldn't if McCarran-Ferguson were repealed. If I may use the shoe store analogy, if you could get shoe stores together under the auspices and the invitation of an attorney general and say what can we do to get prices for the people in our State—having that kind of an informal discussion at the invitation of the attorney general I doubt would violate antitrust laws.

Mr. Berrington. Let me explain what the problem would be. It is a little bit different than shoe stores and putting a price out there for shoes and people coming in.

The problem is this, that if the McCarran-Ferguson Act is repealed, Senator, the standard by which companies can collaborate will be the State Action doctrine. Under the State Action doctrine, which is Supreme Court law dating from *Parker* v. *Brown* in 1943, the only types of State insurance laws that would survive would be those that met two criteria. The first criterion would be the requirement that the State law be designed to displace competition. Therefore, the Illinois insurance law would go down the tubes the first day, because the Illinois law is not designed to displace competition.

The second criterion is that even if it is designed to displace competition, it must be actively supervised. We know from recent Supreme Court decisions, including one that just came down a few weeks ago, the *Patrick* case, that the question of active supervision is one that, even if you meet the first criterion, will be litigated day in and day out by people who are dissatisfied with the way they have been treated in the insurance market. Anyone who is dissatisfied with a marketplace decision will say that the area wasn't actively supervised, and bring litigation.

Now, what happens when the insurance commissioner brings insurance companies together in his office and says, "We're going to do something here." The insurance commissioner of Illinois has a law which promotes competition. Those insurance companies are being asked to get together, to make agreements to divide up the risks, to set underwriting standards, to take one territory or another territory. And inevitably, there are going to be people who have day care centers, if we're going to use that example, who won't get insurance because they shouldn't—they run a dangerous place, cannot meet underwriting standards. Well, they're going to bring antitrust litigation, Mr. Simon, based on those agreements. And that type of antitrust litigation, the inevitability of it, will make certain that major insurance companies will never participate in those activities with insurance commissioners. No general counsel of any insurance company would ever let his people do it because the antitrust exposure is so great.

What we have now is a system that allows the insurance commissioners of the States to deal with issues as they come up and to deal with them in a tough and effective way and bring people together. It couldn't be done, Mr. Simon—it would not be done, it will not be done—if the McCarran Act is repealed.

Senator Simon. I guess we just fundamentally disagree.

Let me just add one other point, if I can make an analogy. The coal industry—Illinois has more coal reserves than any other State. I want a healthy coal industry. We have an acid rain problem. The coal industry as a whole—with the exception of a few industries who whisper to me, "You're right"—the coal industry as a whole says, "We've just got to study this problem a long, long time; we have to resist any acid rain legislation."

The reality is this Nation is going to have acid rain legislation, and the coal industry ultimately is just hurting itself by its obstinacy, by its failure to recognize that train coming down the track.

In the insurance industry, I have leaders of the insurance industry who will whisper to me: "You're right. We really ought to modify McCarran-Ferguson." But the industry as a whole is just not facing reality. And let me tell you, that train is coming down the track.

And you are either going to have a part in shaping a sensible answer or, like the coal industry, you can get hurt. I hope the coal industry soon does the rational thing, because I want a healthy coal industry in my State and in this Nation. I hope the insurance industry does a rational thing soon, because I want a healthy insurance industry in my State and in the Nation.

Mr. **Berrington**. Just one quick comment, Mr. Simon. I appreciate that. But the question isn't solely the insurance industry being hurt; it is a question of insurance consumers being hurt; the question of there being fewer competitors, less availability and more anti-free market regulation. The Insurance Code in Illinois could not exist as a free market operation without the type of State law which exists in Illinois now. And if McCarran were repealed, that Illinois law and the activities of the insurance commissioner under it, would be in doubt.

Senator **Simon**. Mr. Berrington, you are a very articulate spokesman for your industry. I would just admonish you and the others here from the industry, listen to those of us who want to protect consumers, who want to protect your industry—and that train is coming down the track.

Thank you, Mr. Chairman.

Senator **Metzenbaum**. Thank you very much, Senator Simon. Mr. Berrington, you have heard the voice of reason, and I hope you get the message. He says it so reasonably; I say it so passionately, but the point is, we both think we're going to get a bill. I hope we can achieve that objective.

I want to thank you very much, Mr. Berrington, for being with us, and thank you, Professor Priest.

Professor **Priest**. Thank you, Mr. Chairman.

I am George Priest——

Senator **Metzenbaum**. Oh, wait a minute. I cannot give you time at this point. I understood that you were making the presentation for the industry, and that's the reason I allowed you well over half-an-hour to do so; and I assumed that Professor Priest was accompanying you.

I just must go to these other four witnesses. I must be at the Democratic Conference at 12:45. I assumed he was along as a backup, and as I understand, speaking also for the AIA; is that right, Professor Priest?

Professor **Priest**. No, sir, that's not right. I have been invited here by the Insurance Association, but I am an independent academic, and I am speaking only my own views. These are not the views of the association, to my knowledge. I haven't inquired, actually, as to what the views of the association are.

I teach antitrust, and I teach insurance, and I teach tort law, and I was invited again by the association to express my views and my analysis of the crisis and the relationship of this suit to the insurance and liability crisis.

Senator **Metzenbaum**. I am terribly apologetic. It was my misunderstanding. I perhaps should have asked. So that I don't offend you, please take 2 or 3 minutes and give us a summation, because that is what I am going to have to do with Mayor Coyne, who is from my own community, Brook Park, Ohio, and the executive director of the Texas Easter Seal Society, and two other witnesses who we still have to hear yet today.

Professor **Priest**. Thank you, Mr. Chairman. I'll try and summarize my views in just 2 or 3 minutes.

As I say, I am an academic; I teach antitrust law, and like you, I am committed to the antitrust laws and suspicious as a general matter of industry activity. And as these developments in 1984 and 1985—the liability crisis—began to accumulate, I tried as a teacher in these areas to study them and to try and figure out what was behind them. And several puzzles arose.

The first puzzle was that the principal phenomenon, which many people today have focused upon is that insurance companies were refusing to offer coverage to some groups, to municipalities, to day care centers and others, refusing to offer coverage at any price.

Now, that is a curious form of behavior. It is curious for a profit-maximizing cartel to refuse to offer the product at any price. It is hard to maximize any profits where there are no profits, where you are not selling the product.

The second puzzle that I found was that this crisis, these problems, were occurring only in the commercial casualty insurance lines and only with regard to those types of activities that are subjected to long tails of liability. And most telling in this respect is that those activities which generate long tails of liability are exactly those activities for which courts have expanded legal liability since the mid-1960s.

And again, trying to conserve time, I won't go through all of the phenomena—I tried to look at every phenomenon of the crisis and tried to understand it. I think there is a pattern there, and I think the pattern is the expansion of liability, the expansion of tort liability, that has served to undermine the commercial casualty insurance market.

Now, it is in that regard that I interpret or try to make sense of the two features of this current lawsuit which the insurance industry has been accused of colliding over. The first is the adoption of the claims-made policy. Now, the claims-made policy, if you look at it, you can see that it really only affects differently a certain set of operations—municipalities and enterprises that generate toxic waste of one type or another. But for the wide set of insurance, there is no difference, really, in effect between a claims-made policy and an occurrence policy. For the auto driver, claims-made policy would be the same as an occurrence policy, because the claim when one gets into an auto collision is made within a short period of time of the occurrence of the loss. It is only with regard to doctors and municipalities and polluters that there is a very long period of time between the occurrence of the injury and the time the claim is made that that provision makes any difference. That suggests that there are very good reasons to treat those parties differently. There are very good reasons to set aside and treat differently polluters or those who generate those types of losses from the rest of us and from other operations that don't.

The alternatives, really, for the industry—and I'll conclude with this point—the alternatives, really, were to use an occurrence policy, or to use a policy without a pollution exclusion and spread all of those larger costs over all of the operations of the society or to exclude polluters, let them buy insurance separately and introduce a claims-made policy so that those particular activities would pay the higher costs and pay their own way themselves.

In that respect it is my conclusion—and I'm sorry I can't give you the full flavor of what has led me to this conclusion, because it has been many years of study—it is my conclusion that these terms, these policy terms, really benefit consumers. And they benefit consumers by keeping prices low, and as a consequence, it is very unlikely to be, in fact can't be, the result of an illegal conspiracy under the antitrust laws.

Thank you.

Senator **METZENBAUM**. Thank you very much, Professor Priest. I might say that your statement and Mr. Berrington's statement in their entirety will be included in the record.

I apologize to you for the circumstances.

I have no questions. Senator Simon, do you have any questions?

Senator **SIMON**. Very briefly. You mentioned that you are here just independently; is that correct? You are not here as a spokesperson for the industry?

Professor **PRIEST**. I have been invited by the Association, but I told them at the outset that I am not interested in finding out the specifics of their views, that I am going to answer your questions sincerely, according to what I believe, and they have got to take the risk as to whether my views correspond with theirs or not.

Senator **SIMON**. And are you being paid by them to come here?

Professor **PRIEST**. I am receiving a fee, yes, sir.

Senator **SIMON**. Thank you, Mr. Chairman.

Senator **METZENBAUM**. Thank you.

Thank you very much, Mr. Berrington.

Mr. **BERRINGTON**. Thank you for your courtesy, Mr. Chairman.

Senator **METZENBAUM**. Thank you. And again, I want to repeat that my door is open.

Mr. **BERRINGTON**. Thank you. We'll take advantage of that.

[Prepared statement of Professor Priest follows:]

Testimony

of

George L. Priest

John M. Olin Professor of Law and Economics, Yale University

before the

Subcommittee on Antitrust, Monopolies and Business Rights

Committee on the Judiciary

United States Senate

June 14, 1988

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My name is George L. Priest. I am the John M. Olin Professor of Law and Economics at Yale Law School. I am appearing today at the request of the American Insurance Association, but I do not speak for the Association. I have insisted as a condition of my appearance that I present only my personal views concerning these issues. I have not inquired as to the specific policies of the American Insurance Association. As a result, I do not know the extent to which my views correspond to those of the Association. Many of the opinions I will express today have appeared in previously published articles of mine which I should be happy to make available to the Committee.

I teach antitrust law, tort law, and insurance. Like members of this Committee, I am committed to the active and vigorous enforcement of the antitrust laws. Moreover, like all students of the history of industrial organization in this country, I am suspicious of industry agreements and of joint or parallel firm activities.

In recent years I have devoted much of my research to modern developments in tort law. I have studied the changes in tort doctrine since the early 1900s and, in particular, the rapid expansion of tort law since the mid-1960s.[1] I have been especially concerned with the connections between the expansion of tort liability and the extraordinary changes in commercial insurance markets since 1984, which we have come to call the "liability crisis". I have published extensively on the sources of crisis and on its effects on American consumers.[2]

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[1] See G.L. Priest, The Invention of Enterprise Liability: A Critical History of the Intellectual Foundations of Modern Tort Law, 14 J. Legal Studies 461 (1985). Also see G.L. Priest, "Strict Products Liability: The Original Intent" (mimeo, 1988).

I would like to explain today my views on the relationship between the McCarran-Ferguson Act, the liability crisis, and the lawsuits brought by the various Attorneys General against several insurers and reinsurers.[3] I wish to present two conclusions I have drawn from my research:

1) The liability crisis in commercial casualty insurance lines could not have been the result of insurer collusion in violation of the antitrust laws, but was the consequence of the rapid expansion of commercial tort liability.

The Attorneys General have claimed that groups of insurers and reinsurers illegally colluded to achieve three changes in commercial liability policies: the exclusion of pollution coverage, the adoption of a claims-made rather than an occurrence basis for commercial policies, and the inclusion of defense costs in a policy's aggregate coverage limit. These three policy changes cannot have resulted from illegal collusion for two reasons:

First, these insurance coverage changes are closely similar to contemporaneous changes in activities and operations introduced by self- or non-insured manufacturers and municipalities. No one could believe that self- or non-insured entities would be parties to insurer collusion. Self- or non-insured entities, however, are affected in exactly the same way that insurers are affected by the expansion of tort law. As I shall demonstrate below, the expansion of tort law compelled the self- and non-insured to radically change their activities just as it compelled the insurers and reinsurers to modify commercial casualty policies by excluding pollution coverage, adopting the claims-made policy, and including defense costs in the coverage limit.

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[2] See G.L. Priest, The Current Insurance Crisis and Modern Tort Law, 96 Yale L.J. 1521 (1987); G.L. Priest, Puzzles of the Tort Crisis, 48 Ohio State L.J. 497 (1987); G.L. Priest, The Liability Crisis: A Diagnosis, 1987 Yale Law Report 2 (Fall 1987); G.L. Priest, Products Liability Law and the Accident Rate, in Liability Perspectives and Policy at 184 (Litan & Winston eds., Brookings Inst. 1988); G.L. Priest, Understanding the Liability Crisis, forthcoming in New Directions in Liability Law (Proceedings of the Academy of Political Science) (W. Olson, ed. 1988).

[3] I wish to emphasize that I have no relationship with any of the defendants in the case and am expressing only my personal opinions.

Secondly, none of these changes in insurance coverage could have increased insurer profits. The antitrust laws prohibit industry agreements that restrain trade in order to achieve supracompetitive profits. It is well-established in the law and it is sound antitrust policy that industry-wide agreements that do not or cannot achieve supracompetitive profits by restraining trade do not violate the antitrust laws.[4] If pollution, claims-made, or defense cost coverage could have been provided at a profit, then the refusal of insurers to offer such coverage would only have reduced, rather than increased, firm profits. On the other hand, if these forms of insurance coverage could not have been provided at a profit, it was only a sensible business decision to withdraw them from the market. As a consequence, these coverage withdrawals could not have restrained trade in violation of the antitrust laws. For this reason, as explained further below, it is irrelevant for purposes of antitrust law whether the defendants introduced the changes unilaterally or jointly by agreement.

It follows that the liability crisis is unrelated to the McCarran-Ferguson exemption from antitrust liability. The McCarran-Ferguson exemption had no impact on the liability crisis of 1984-86. Neither the retention nor the repeal of McCarran-Ferguson will serve to abate the current crisis nor, more importantly, to reduce the prospect of future crises. The recent crisis should have no influence on the Senate's consideration of the McCarran-Ferguson Act.

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[4] Matsushita Electric Industrial Co. v. Zenith Radio Corp., 475 U.S. 574, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986).

2) The lawsuits brought by the Attorneys General against the insurer and reinsurer defendants have little relationship to the McCarran-Ferguson Act.

The McCarran-Ferguson Act appears central to the lawsuits because the Attorneys General have characterized the insurer actions as a boycott, a practice excepted from the antitrust exemption by the Act's Section 3(b). In fact. the insurer practices at issue cannot be construed as a boycott in violation of the antitrust laws, as I will explain further below. Thus, the McCarran-Ferguson Act is largely irrelevant to the antitrust claim. Though a great deal of legal expense will be invested on McCarran-Ferguson issues, the heart of the case should be decided without regard to McCarran-Ferguson. As a consequence, these lawsuits should have no influence on the Senate's consideration of the McCarran-Ferguson Act.

I. The Liability Crisis: Collusion or the Expansion of Tort Liability?

Between the late months of 1984 and the early months of 1986, reports began to accumulate of unusual changes in particular commercial casualty insurance lines. Most prominent were announcements of extraordinary increases in yearly insurance premiums, increases of 60 or 100 or, in some instances, of 1500 percent. These very large and seemingly sudden increases in insurance prices led many who study and teach in the antitrust field immediately to suspect collusion, since it was difficult to believe that insurer adminstrative costs or underlying liability claims had suddenly risen by equal proportions.

Further study of the industry, however, disclosed that the increases in insurance premiums were only a subset of a much wider range of phenomena affecting commercial insurance. Because these other phenomena were very closely related to the premium increases, those who suspected insurer collusion were forced to explain how all of the other similar activities were consistent with illegal collusion. For example, in addition to increases in commercial liability premiums, insurers were radically changing the definition of insurance coverage. Insurance deductibles were increased. Levels of aggregate coverage were reduced, both explicitly and, in some instances, by including defense costs within the aggregate coverage limit.

In addition, insurers began to exclude specific activities and liabilities from coverage altogether. Pollution claims were excluded from comprehensive general liability coverage; employment discrimination claims were excluded from municipality coverage; claims related to merger and acquisition activity were excluded from Directors' and Officers' coverage. In a small number of specific insurance lines, the claims-made policy was substituted for the occurrence policy. Indeed, in still other insurance lines--day care, nurse-midwife and municipality coverage--insurers refused to offer insurance at any premium, though the affected individuals and entities were often begging for coverage.

These changes in insurance coverage forced many small corporations, in some cases, to increase product prices to reflect higher insurance costs and, in other cases, to remove products and services from the market altogether. Many ski lifts closed down or sharply restricted activities. Small bus companies cancelled the more risky of their services. Swimming pool supply companies curtailed sales of diving boards and pool slides.

Even large self-insured entities began to take similar actions. Cities and park authorities removed playground equipment from public parks. Major school systems, such as that of the self-insured City of New York, removed diving boards from school swimming pools. Large numbers of self-insured manufacturers increased prices because of higher liability exposure. A Conference Board survey reported that 25 percent of Fortune 500 firms had removed products from markets for liability reasons--vaccines, chemicals, and intrauterine devices, among others.

The more widespread character of these phenomena deeply undercut the theory that the changes had resulted from insurer collusion. First, the self-insured corporations and municipalities had reacted in exactly the same way as had commercially insured entities: they had either raised product prices because of higher expected liability costs or had withdrawn the most risky products and services from markets. Surely the self-insured entities had no reason to be parties to insurer collusion. That they had engaged in largely identical practices strongly suggested that some deeper set of forces, rather than more particular insurer collusion, had affected all of these commercial activities.

The insurer collusion theory was also undercut by more careful analysis of the insurer practices alone. A monopolist or a cartel maximizes profits by charging a supracompetitive price. There is no theory that suggests that a cartel can maximize profits by radically changing the characteristics of its product. Yet that is what the commercial insurers had done. By increasing deductibles, altering levels of aggregate coverage, and incorporating new exclusions, the insurers and reinsurers had drastically changed the nature of the insurance product for some set of insurance consumers. And the changes that the insurers had introduced had clearly made the insurance product less attractive than it had previously been for the insurance consumers affected. Reducing the attractiveness of a product can only reduce, rather than increase, product sales and firm profits.

For example, the widespread increases in insurance deductibles, reductions in the level of aggregate coverage, and the inclusion of defense costs in policy aggregates serve to reduce the attractiveness of commercial insurance for affected insurance consumers. Where deductibles are increased, insurance becomes less attractive for firms that generate relatively more frequent claims, since they are forced more frequently to absorb the higher deductible amounts. Similarly, reductions in the level of aggregate insurance coverage reduce the attractiveness of insurance to firms that face relatively larger liability exposure, since they are forced to bear themselves losses above the aggregate level or to find sources of excess levels of insurance. By the same reasoning, changing the commercial policy to include defense costs in the policy aggregate makes the policy less attractive for firms that generate relatively higher defense expenditures, whether because of the relatively higher frequency or the greater complexity of claims filed against them.

For these insurance consumers, a reduction in the attractiveness of insurance will either reduce the amount of commercial insurance they will demand, by increasing the relative attractiveness of self-insurance or other methods of risk diversification, or it will reduce the amount they will be willing to pay for the insurance they are offered. Neither of these responses by insurance consumers, however, could benefit a profit-maximizing insurer or reinsurer cartel.

The introduction of new policy exclusions will have the same effect. Excluding pollution coverage from the comprehensive general liability policy will make the policy less attractive to firms or municipalities that anticipate future pollution-related claims. Excluding coverage of claims related to mergers and acquisitions from a Directors' & Officers' policy will make commercial D & O liability insurance less attractive to firms relatively more active in the market for corporate control.

Shifting from an occurrence to a claims-made basis is identical. All insurance is sold for a specific time period subject to renewal at the end of the period. If, during one policy period, the insurer gains information leading to a more accurate prediction of future claims costs, the insurer will adjust the premium charged for the next period, either up or down, depending upon the new estimate. An occurrence policy provides coverage of all losses that occur during the policy period, regardless of when the claim relating to the accident is filed. A claims-made policy, in contrast, provides coverage of all claims filed during the policy period, regardless of when the underlying accidents occurred.

For most types of accidental liability, there will be no effective difference between an occurrence and a claims-made policy because claims under the policy will typically be filed within a short period of the occurrence of the accident. The claims-made policy will differ from the occurrence policy, however, where some large set of accidents occurred a substantial period prior to the time the claims based upon the accidents are filed, like asbestos or other toxic injuries. Under a claims-made policy, as such claims begin to accumulate, the insurer can revise its expectations of future liability more readily, increasing the premium or, in extreme cases, deciding not to renew for subsequent policy periods, thus requiring the affected firm to self-insure. In contrast, if the coverage had been written on an occurrence basis, there would be no way for the insurer to act upon its now more accurate estimate of future liability costs since the occurrence coverage against which the claims are filed was written long prior to the filing of the claims.

The claims-made basis, thus, is a method of enhancing the ability to predict the liability costs of insureds who generate what is called "long tail" liability: liability based upon a series of accidents that occurred many years before. In more typical accident contexts, claims-made coverage hardly differs from occurrence coverage because there is no substantial delay between the occurrence of the accident and the filing of the claim. For example, it would not matter in the slightest whether an auto liability policy were written on a claims-made or an occurrence basis. It is for this reason that the claims-made policy has only been introduced in the very small number of lines affected by long tail liability.

In accident contexts relating to long-term cumulative health damage, however, claims-made coverage will differ substantially from occurrence coverage. Again, for insureds that have generated long tail liability, claims-made coverage is much less attractive than occurrence coverage because, as the claims they generate begin to accumulate, the revised estimates of the insurer compel it to increase the effective premium that the insureds must pay or to force the insureds to bear more of the losses themselves.

In this respect, shifting to a claims-made policy has an effect identical to lowering levels of aggregate coverage, increasing deductibles, or excluding pollution coverage. All of these coverage changes make insurance less attractive to some set of insureds. Higher deductibles make insurance less attractive for firms generating relatively more frequent claims. Lower aggregate policy levels (including, incorporating defense costs in the aggregate) make insurance less attractive for firms generating relatively larger levels of exposure. Pollution exclusions make insurance less attractive for firms that face relatively greater responsibility for generating or monitoring pollution. Claims-made policies make insurance less attractive for firms generating relatively longer tails of liability.

What makes the insurer collusion hypothesis most implausible is that there is no way that colluding insurers or reinsurers could increase profits by agreeing to make the insurance product less attractive to affected consumers. It is totally implausible (and no one has ever alleged) that each of the thousands of commercial liability insurers were parties to the collusive agreement. But if not, an agreement by some insurers or reinsurers to make the insurance product less attractive could only reduce their sales and profits because it would increase the opportunity for insurers outside the agreement to offer a more attractive product. Put more simply, if pollution, defense cost or occurrence coverage could be offered on attractive terms, then a collusive agreement to refuse to offer such coverage would harm the economic positions of the colluders themselves.

The withdrawal of pollution, defense cost and occurrence coverage are only more particular instances of the general withdrawal of products for liability reasons during this period. As is well known, many insurers individually decided not to write coverage on any terms to day care centers, nurse midwives or municipalities, though these entities appeared willing to entertain any premium for such coverage. No one could imagine that the refusal to offer coverage at any premium is a method of maximizing profits. The great industrial conspiracies of our Nation's history--the Standard Oil Trust; United States Steel; more recently, the electrical equipment conspiracy--did not maximize profits by refusing to sell their products to buyers seemingly willing to pay any price; quite the reverse. If pollution, defense cost or occurrence coverage could have been offered at a profit, then the exclusion of such coverage would have lowered, rather than increased, insurer profits.

These various restrictions in the terms of insurance coverage, in fact, closely resemble the more general withdrawal of products for liability reasons during the 1984-86 period. Large numbers of manufacturers withdrew products because of expected liability costs. Most telling are the product withdrawals by very large corporations, those that generally self-insure or diversify corporate risks by other means. As mentioned earlier, a 1987 survey of Fortune 500 manufacturers discovered that 25 percent had withdrawn products from the market for liability reasons.[5] This is strong evidence that manufacturers shared the expectations of insurers and reinsurers that future tort liability costs would increase. More recently, a 1988 survey of both large and small firms demonstrates that the total effects of expanded tort liability have been even more severe. The survey found that, in aggregate, 47 percent of firms had discontinued product lines, 39 percent had decided against introducing new products, and 25 percent had discontinued new product research, all because of expected future tort liability.[6]

A manufacturer only withdraws a product from the market when it cannot find a sufficient number of buyers willing to pay a price that covers operating costs. Similarly, an insurer or a group of insurers only withdraws forms of insurance coverage where the costs of providing the coverage exceed effective demand. Far from increasing profits and profit opportunities, product withdrawal and insurance coverage withdrawal, reduce profits and profit opportunities.

It is not possible to profitably insure every societal risk. Where risks become so highly concentrated and dependent that they cannot be effectively spread, insurance at a profit is impossible; the risks become uninsurable. The impossibility of insuring for losses related to nuclear war is an easily appreciated example.

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[5] N. Weber, Product Liability: The Corporate Response 4-7 (Conf. Bd. 1987).

[6] E. Patrick McGuire, The Impact of Product Liability at 20, Table 30 (Conf. Bd. 1988).

The expansion of legal liability tends to concentrate and reduce the independence of risks.[7] Today, it is impossible to purchase insurance for asbestos-related injuries, though 20 years ago, prior to the expansion of manufacturer liability for such injuries, insurance for such risks was readily available. Put differently, 20 years ago, insurers thought that they could profit from the sale of insurance for asbestos-related activities; today they know that such coverage will never be profitable. The expansion of legal liability has served to reduce the profit opportunities of insurers in this respect, just as insurers today face fewer or non-existent profit opportunities in pollution, occurrence or defense cost coverage.

It is for this reason that the coverage changes introduced by commercial insurers cannot constitute a violation of the antitrust laws. An action that reduces profits and profit opportunities cannot be a restraint of trade. It is, thus, largely irrelevant whether the changes in insurance coverage were introduced unilaterally by individual insurers and reinsurers or by the insurers and reinsurers in concert.[8]

Antitrust enforcers, of course, must remain suspicious of joint industrial activities. With respect to joint industry agreements, however, the insurance industry differs from other industries because of very strong state regulatory pressure to standardize insurance policies. The purpose of this state regulation is to simplify insurance forms to facilitate consumer comprehension of insurance offerings. The easier it is for consumers to compare different policies, the greater the level of competition in the industry, and the more the competition will focus on price rather than less fungible differences in insurance coverage. Along with preserving insurer solvency, standardization is the most basic justification for insurance industry regulation.

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[7] See Ralph A. Winter, The Liability Crisis and the Dynamics of Competitive Insurance Markets, 6 Journal on Regulation 455 (1988).

[8] I discuss the more precise legal claims of the Attorneys General in the next Part.

In many contexts, as a consequence, the policy in favor of insurance standardization complicates the antitrust evaluation of insurance industry agreements. It is frequently necessary in considering insurance industry practices to weigh uniformity interests against antitrust interests. This is the point of the McCarran-Ferguson Act.

There is no policy conflict of this nature, however, with respect to the withdrawal of pollution, occurrence, and defense cost coverage. Because these withdrawals in coverage could not have increased insurer profits, they could not have caused antitrust injury. It appears that the litigants are already disputing whether the named insurer and reinsurer defendants possessed sufficient market power to restrain trade. The market for commercial liability insurance is essentially the market in commercial risk diversification. When the multiple ways that businesses diversify risk are taken into account, it is unlikely that the defendants' market power was substantial.

But the market power analysis is largely irrelevant. Where there is no antitrust injury, it is unimportant whether the named defendants did or did not possess market power. Again, since the joint agreement to withdraw pollution, occurrence, and defense cost coverage could not have increased their profits and could only have pushed affected insurance consumers to the defendants' competitors, there was no antitrust injury.

There is one further piece of evidence that strongly confirms that it was the increase in expected liability costs, rather than collusion that was the source of the liability crisis. Although the aggregate effects of the crisis on our economy insurance and to manufacturing and service industries. For example, the crisis has affected only a small number of lines of commercial liability insurance. Personal insurance lines have been totally immune from crisis, as have other lines of commercial insurance. Similarly, only particular providers of products and services have been affected by the crisis, for example, tool and chemical manufacturers, and service providers in some medical fields as well as municipalities.[9] Again, within these manufacturing and service industries, firms and providers were affected whether they purchased commercial liability insurance or were self-insured.

This narrow, localization of effect, however, undercuts the collusion explanation. For three separate reasons, commercial liability insurance is the least likely insurance field to support successful collusion:

First, commercial insurance customers are less vulnerable to collusion because they are more likely to be price sensitive, more able to shop around, and more knowledgeable about differences in insurance coverage.

Second, entry to compete with colluding firms is extraordinarily easy in the commercial liability insurance industry. Commercial risk diversification is essentially a matter of accumulating assets. There are few state regulatory limitations on entry to the licensed market and basically none to entry to the surplus lines market. It would be very easy for the already-licensed insurers to expand their insurance offerings to lines subject to collusion. Moreover, entry into commercial "insurance" is easy for the affected insureds themselves. Insureds can easily form captive insurers which, since the early 1980s though for other reasons, have come to command somewhere between 25 and 50 percent of the commercial market.[10] In addition, captive insurer or not, there are many techniques for commercial entities to self-insure, including asset or investment diversification and operation in the conglomerate form, among others.

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[9] For a more comprehensive description, see, G.L. Priest, The Current Insurance Crisis and Modern Tort Law, 96 Yale L.J. 1521, 1582-1587 (1987).

Third, in the affected commercial liability lines, underwriting is most often conducted on a special risk basis, rather than a class basis, which means that insurers will typically offer each insured an individualized premium based upon the particular riskiness of the insured's operations (i.e., whether the insured has installed sprinkling systems, adopted safety or training programs, and the like). Because of the strong incentive in any collusive agreement to cheat on the cartel price, collusion is much less likely to be successful (and over the years has seldom been attempted) where product heterogeneity of this nature dooms efforts to police the agreement. Collusion is a much more promising tactic, in contrast, where consumers are more vulnerable, regulatory constraints on entry are more rigorous, and the product is more homogenous so that adherence to a cartel agreement can be more readily monitored.

Most importantly, however, the commercial insurance lines affected by the crisis as well as the manufacturing and service industries affected by the crisis are exactly those that have been most dramatically affected by changes in tort liability. Since the mid-1960s, tort liability has been expanded generally with respect to corporate activities, both in terms of the extension of affirmative duties and the restriction of available defenses.[11] But these doctrinal changes have had the most dramatic effects in two separate areas. The relaxation of have had the most dramatic effects in two separate areas. The relaxation of causation standards and the erosion of statutes of limitation have particularly affected manufacturers of machine tools, pharmaceuticals and chemicals as well as various medical subspecialties. These enterprises now face long tails of liability exposure that they never faced in earlier years.

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[10] For a discussion of how the expansion of tort liability increases the attractiveness of the captive insurer form, see G.L. Priest, The Current Insurance Crisis and Modern Tort Law, 96 Yale L.J. 1521, 1550-63, 1570 & nn.192,193 (1987).

[11] See generally, G.L. Priest, The Invention of Enterprise Liability: A Critical History of the Intellectual Foundations of Modern Tort Law, 14 J. Legal Studies 461 (1985).

In addition, the relaxation of causation standards, the adoption of the doctrine of comparative negligence and the resilience of joint and several liability have particularly affected large entities with vast and disparate operations, such as municipalities and utilities. Together these legal doctrines sweep these large entities into the liability net with much greater frequency than ever before and with much greater financial liability than ever before.[12] The greater liability exposure of these entities is the reason that those that were self-insured were compelled to withdraw products and services and that those that were commercially insured faced premium increases and coverage restrictions.

There has been yet an additional effect of changes in modern tort law on the commercial insurers themselves. As part of the general expansion of liability, courts have adopted as the central principle for interpreting insurance contracts the goal of maximizing insurance coverage. As part of this approach, courts have read insurance policy coverage provisions broadly and restrictions and exclusions narrowly in order to affirm insurance coverage as frequently as possible.

This approach has been particularly noticeable in contexts of claims involving pollution-related losses. Much attention has been given to the 1982 New Jersey Jackson Township decision interpreting an insurance provision covering

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[12] The doctrine of comparative negligence empowers a jury to assign small percentages of responsibility to operations only remotely implicated in accidents in contexts where, years before, actions against such defendants would be dismissed. Frequently, the doctrine of joint and several liability leaves municipalities, utilities and other large corporations chiefly responsible for ensuing judgments.

"sudden and accidental" pollution to incorporate coverage of prolonged seepage.[13] This judicial philosophy in favor of construing a policy exclusion narrowly, however, extends far beyond Jackson Township. Courts have adopted similar interpretations of the "sudden and accidental" provision in Maine, New York, Washington, Ohio, Massachusetts, Colorado and Idaho.[14] In still other cases, courts have adopted novel interpretive techniques in order to hold insurers responsible for the losses that insurers had attempted to exclude.[15]

In this light, it is evident that the function of the coverage changes introduced by the insurers and reinsurers is to treat polluters and enterprises that generate long tails of liability separately from other commercial insureds. As described above, the pollution exclusion, the claims-made policy, the lowering of aggregate policy levels and the increasing of deductibles makes the commercial policy less attractive to insurance purchasers, respectively, with relatively higher pollution exposure, relatively longer tails of liability, relatively greater defense costs, or relatively more frequent claims susceptibility. By contrast, the incorporation of these restrictions on insurance coverage makes commercial insurance more attractive to insureds with relatively lower levels of these exposures.

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[13] Jackson Township Municipal Utilities Authority v. Hartford Accident and Indemnity Company, 186 N.J. Super. 156, 451 A.2d 990 (1982).

[14] Travellers Indemnity Co. v. Dingwell, 414 A.2d 220 (Me. 1980); Allstate Ins. Co. v. Klock Oil Co., 73 App. Div. 2d 486, 426 N.Y.S.2d 603 (1980); United Pacific Ins. Co. v. Van's Westlake Union, Inc., 34 Wash. App. 708, 664 P.2d 1262 (1983); Buckeye Union Ins. Co. v. Liberty Solvents and Chemicals Co., Inc., 477 N.E.2d 1227 (Ohio App. 1984); Shapiro v. Public Service Mutual Ins. Co., 19 Mass. App. 648, 477 N.E.2d 146 (1985); City of Northglen v. Chevron U.S.A., Inc., 634 F.Supp. 217 (D. Colo. 1986); State of Idaho v. Bunker Hill Co., 647 F.Supp. 1064 (D. Idaho 1986).

[15] Farm Family Mutual Ins. Co. v. Bagley, 64 A.D.2d 1014, 409 N.Y.S.2d 294 (1978) (intentional act with unintended result is "accidental"); Broadwell Realty Services, Inc. v. Fidelity & Casualty Co. of New York, 528 A.2d 76 (N.J. Super. A.D. 1987) (intentional act with unintended result is "sudden"); see also Pepper Industries, Inc. v. Home Ins Co., 134 Cal. Rptr. 904 (Cal. App. 1977).

The pollution exclusion compels firms or municipalities potentially responsible for pollution-related injuries to buy pollution coverage separately or to self-insure for such claims. Segregating those subject to pollution claims from those commercial insureds not subject to such claims means that the costs of pollution will not be averaged into the premiums of the non-polluters. The exclusion of pollution coverage forces polluters and those responsible for pollution to pay their own way.

The claims-made policy operates similarly. The claims-made policy is a way of splitting off those who generate long tails of liability from the rest of the business community. The claims-made policy forces those who cause latent injuries to pay the higher costs for which they are responsible. The claims-made policy, thus, lowers insurance costs for those who have not generated such liability. For a similar reason, the inclusion of defense costs in the aggregate policy limit increases total insurance costs for firms that generate high defense costs, but lowers total insurance costs reciprocally for firms that can attain better control over such costs.

There is no particular reason that cartelization within the insurance industry would lead to greater efforts to segregate one set of insureds from another. On the other hand, where the expansion of tort liability increases the liability exposure of polluters relative to non-polluters or of firms generating long tails of liability relative to firms not generating such tails, there is a very good reason to segregate these groups. Segregation of insureds according to risk level expands insurance availability, because it makes insurance more attractive to the relatively low risk within any insured population.[16] Since the premium charged to a group of insureds must be set equal to the average expected costs of the group, low risk insureds benefit if the high risk are segregated into separate groups paying separate (higher) premiums. Again, segregation forces those insureds generating higher liability costs to pay their own way.

There is an additional important public policy grounds for encouraging the segregation of polluters and other high risk insureds into separate insurance pools. A central ambition of tort law is to create financial incentives to improve the level of safety in our society. It is a fundamental premise of modern law to charge manufacturers and other tortfeasors differentially according to the levels of injury their products and activities cause. Our society invests very little in the direct regulation of product safety. Instead, we rely in largest part on the marketplace to police safety levels. Accordingly, we expect that if one product is relatively more dangerous than another, the higher liability costs that tort law imposes will either compel the manufacturer to invest to make the product safer or will compel the product to be sold at a higher price, with resulting lower demand. This is the basic underlying premise of strict products liability.[17]

It has long been recognized that insurance for liability costs blunts safety incentives. The purpose of insurance is to lower the expected costs of risky activities. Expected liability costs with insurance will be lower than expected liability costs without insurance. Again, since the premium for an insurance pool must be set with respect to the average risk of the pool, the more that low risk insureds (those generating low tort liability costs) are merged with high risk insureds (those generating high tort liability costs), the lower the effective premium to those generating high costs.

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[16] For a further elaboration, see G.L.Priest, The Current Insurance Crisis and Modern Tort Law, 96 Yale L.J. 1521 (1987).

[17] See, e.g., Greenman v. Yuba Power Prods., Inc., 59 Cal.2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963) (in bank).

It follows that more extensive segregation according to risk level increases the correspondence of insurance costs to the costs the insured has imposed on society by its activities. Put more simply, segregation in insurance makes tortfeasors pay more of the injury costs they generate. The pollution exclusion, the claims-made policy, and the inclusion of defense costs, just like the increase in deductibles and the lowering of the aggregate insurance level, help to better achieve the ends of tort law by making tortfeasors pay their own way.[18]

It is my conclusion, thus, that the various changes in insurance coverage that form the basis of the Attorneys' General complaint are responses of insurers to the expansion of tort liability, rather than the result of insurer or reinsurer collusion.

Allow me to respond to two further concerns that have been raised about the insurers' coverage changes. Many insureds have complained that the increases in insurance premiums or the other changes in insurance coverage are artificial because they do not derive from demonstrable increases in claims. Typical is the remark that insurance premiums were increased by large amounts, though no (or small numbers of) claims had been ever filed against the insured.[19]

Complaints of this nature mistake the character of the insurance process. Insurance premiums must be based upon expectations of future liability, not upon past liability. Past liability claims, of course provide some evidence of future claims. But in contexts of rapidly expanding tort doctrine, the evidentiary value of the past experience may not be great. Insurance premiums must reflect the state of the law. It is no defense to a current tort action to demonstrate that no claim has ever been filed against the defendant in the past. Commercial insurers can be no more understanding of an exemplary record than the legal system whose costs they pass on.

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[18] It is on this basis that the State of New York in the early 1970s required insurers to exclude pollution coverage, just as many states today compel insurers to exclude coverage of punitive damages.

[19] See, e.g., E. Patrick McGuire, The Impact of Product Liability at 11 (Conf. Bd. 1988) (quoting, separately, remarks of presidents of an electronics firm and a chemical firm).

Secondly, many commentators have emphasized the substantial increase in insurer profits following 1985. An increase in insurer profitability is consistent with collusion (obviously it is the objective of any collusive agreement), and it seems to belie complaints about the uncertainty of tort law. It must be remembered, however, that insurers are no more than financial intermediaries. They provide a risk spreading service, as a buffer between some set of injury-causing activities and the costs the law places upon those activities. As intermediaries, insurers will always be in a position to make a profit. They will make a profit if the law is restrictive; they will make a profit if the law is expansive.[20] Underlying changes in liability rules that compel insurers to withdraw forms of coverage do not clearly affect the profits insurers can earn on remaining forms of coverage. Thus, one would expect insurers to continue to profit though compelled by the expansion of liability to withdraw forms of coverage, just as one would expect a restaurant to continue to profit though compelled by its customers to eliminate high-cholesterol foods. There is interesting new work being conducted on the implications for industry profitability of tax and regulatory constraints on insurer capacity growth.[21] The important issue is not insurer profits themselves, but the appropriate legal regime for controlling the underlying level of harms in the society.

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[20] They will only fail to make a profit--as they failed during the early 1980s--where they drastically misestimate the state of the law and the underlying obligations it imposes.

The most revealing phenomenon that the liability crisis is genuine is that the increase in liability has led to a reduction in available insurance coverage. When insurers are forced by changes in the law to withdraw pollution, occurrence, and defense cost coverage, there are fewer sources against which insured claimants may recover. Continued insurer profits should not disguise the fact that under a different legal regime, insurers could profit even more, because they could provide more coverage and better protection to the potentially injured. The judicial expansion of liability--however well-meaning--thus, has been counterproductive.[22] Its victims are both consumers who would prefer to be protected and the insurers who would prefer to be paid to protect them.

II. The Lawsuits and the McCarran-Ferguson Act

The more precise legal claims of the Attorneys General are that the defendants' withdrawals of pollution, occurrence, and defense cost coverage constitute an "agreement to boycott, coerce, or intimidate", subject to the Sherman Act by McCarran-Ferguson Act Section 3(b). The strength of the claim derives from the uncertain character of the law: there have been very few cases that have interpreted Section 3(b); in addition, the term "boycott" has been applied under the Sherman Act to a wide range of disparate activities.

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[21] See Ralph A. Winter, The Liability Crisis and the Dynamics of Competitive Insurance Markets, 6 Yale Journal on Regulation 455 (1988).

[22] See, generally, G.L. Priest, The Current Insurance Crisis and Modern Tort Law, 96 Yale Law Journal 1521 (1987).

It is my view, however, that the practices in question do not constitute an antitrust boycott because they have caused no imaginable antitrust injury.[23] It follows that the McCarran-Ferguson Act and its limited exemption are irrelevant to the suit. In the absence of antitrust injury, there is no need to invoke the McCarran-Ferguson exemption from antitrust liability. Thus, the lawsuits are irrelevant to the Senate's consideration of the McCarran-Ferguson Act.

It is important at the outset to understand clearly the aims of the antitrust laws. The antitrust laws do not prohibit all industrial agreements. Many, perhaps the large majority, of industrial agreements enhance consumer welfare. The antitrust laws prohibit industrial agreements that restrain trade. A restraint of trade is an artificial interference with market forces designed to increase the profits of a cartel or of a monopolist. The antitrust laws acknowledge that consumers may be affected in many ways by normal market forces: price or output may increase or decrease for reasons related to nothing more than changes in supply or demand. The antitrust laws, thus, are not aimed at price increases or output reductions themselves, but at price increases or output reductions that result from artificial constraints, rather than from underlying changes in supply or demand. It is the artificial agreement to manipulate the market in order to increase cartel or monopolist profits that constitutes an illegal restraint of trade.

Courts have employed the term "boycott" to describe a diverse set of activities involving refusals to sell or buy a product. Most typically, boycotts that violate the antitrust laws are those designed to maximize defendant profits by eliminating competitors. For example, in the Eastern States Retail Lumber Dealers' Assn. case,[24] a group of lumber retailers was convicted of an antitrust violation for agreeing to boycott wholesalers[25] who were also selling at retail. The tactic restrained trade in violation of the antitrust laws because it was designed to increase defendant profits by reducing the extent of retail competition. Similarly, in the classic Fashion Originators' Guild case,[26] a group of dress designers was convicted of an antitrust violation for agreeing to boycott retail dealers who were selling the dresses of competing designers.[27] Again, the boycott restrained trade because it was designed to increase Guild profits by reducing the extent of design competition.

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[23] Thus, I do not need to reach the grounds of UNR Industries, Inc. v. Continental Insurance Co., 607 F.Supp.855 (N.D.Ill. 1984) in which a claim that a concerted switch from occurrence to claims-made coverage was an illegal boycott was dismissed as a "change in terms of coverage", exempt from antitrust liability under McCarran-Ferguson.

The case that inspired the McCarran-Ferguson Act, South-Eastern Underwriters' Assn.,[28] was of exactly the same nature. The Underwriters' Association was convicted of an antitrust violation for agreeing to boycott both insurance agents who wrote policies of non-Association members and the commercial insureds who purchased such policies. Here again, the boycott was designed to increase Association profits by reducing the extent of insurance competition.

Indeed, the Supreme Court has recently clarified the meaning of the term "boycott" by emphasizing that the antitrust laws are particularly suspicious of refusals to deal designed to increase profits by eliminating or disadvantaging competitors.[29] According to the Court, boycotts designed to increase profits by harming competitors constitute per se violations of the Sherman Act. The Court has acknowledged that other forms of boycotts remain subject to the antitrust laws, but subject to review by the much less restrictive rule of reason.[30] The rule of reason obliges a trial court to consider the broad range of competitive conditions in an industry as well as all possible pro-competitive explanations of the practice at issue.

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[24] Eastern States Retail Lumber Dealers' Ass'n. v. United States, 234 U.S. 600, 34 S.Ct. 951, 58 L.Ed. 1490 (1914).

[25] Thus, this case involved a purchasers' boycott.

[26] Fashion Originators' Guild of America v. Federal Trade Commission, 312 U.S. 457, 61 S.Ct. 703, 85 L.Ed. 949 (1941).

[27] The Guild claimed that the targeted designers had pirated Guild members' designs, but the Court found the point irrelevant for antitrust purposes.

[28] United States v. South-Eastern Underwriters Ass'n., 322 U.S. 533, 64 S.Ct. 1162, 88 L.Ed. 1440 (1944).

Obviously, the withdrawal of pollution, occurrence and defense cost coverage cannot be regarded as a classic boycott designed to harm competitors. There is no conceivable way that the refusal to offer certain types of insurance coverage to insurance consumers eliminates insurance competition. On its face, the withdrawal of coverage would feed competition. If pollution, occurrence or defense cost coverage could be offered at a profit, the defendants' agreement to withdraw coverage would push insurance consumers to competing insurers willing to offer it. The withdrawal of these forms of coverage, then, must be characterized as a refusal to sell to certain consumers rather than as a boycott designed to harm or eliminate competitors.

There have been cases in which courts have entertained antitrust claims involving refusals to sell to consumers, and it is upon these cases that the Attorneys General will build the current lawsuits. As we shall see, however, each of these cases has involved a plausible (though, sometimes, thinly plausible) theory according to which the refusal to sell 1) increased defendant profits and 2) was an artificial interference with market processes. The Attorneys' General lawsuits are substantially different because the defendants' agreement to withdraw pollution, occurrence, and defense cost coverage reduced, rather than increased, defendant profits and was not an artificial interference with, but was an inescapable response to, market supply forces. As a consequence the coverage withdrawals did not restrain trade in violation of the antitrust laws.

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[29] Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284 (1985).

[30] Id.

The case that appears to provide the greatest support for the Attorneys' General suit is St. Paul Fire & Marine Ins. Co., et. al v. Barry,[31] in which four insurance companies were accused of conspiring to boycott consumers of medical malpractice insurance to compel them to accept claims-made rather than occurrence coverage. The four defendants were the only commercial malpractice insurers in the market and thus appeared to possess market power, though the trial court did not consider alternative forms of physician risk diversification, including captive insurance sources and asset diversification (self-insurance). According to the complaint, the illegal boycott consisted of St. Paul's announcement that it would only write claims-made malpractice coverage, pursuant to conspiracy with the other three insurers who refused to offer malpractice coverage on any terms, forcing the insureds to accept claims-made policies from St. Paul.

The case was not decided on antitrust grounds, but on motion for summary judgment regarding whether the term "boycott" in Section 3(b) of McCarran-Ferguson applied, as alleged, to boycotts of consumers, or applied only, as in South-Eastern Underwriters', to boycotts designed to harm competitors. The Court held that Congress had intended Section 3(b) to extend beyond boycotts aimed against competitors, and affirmed the reversal of the trial court's summary judgment in favor of the insurer defendants.[32]

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[31] St. Paul Fire & Marine Insurance Co., et al. v. Berry, 438 U.S. 531, 98 S.Ct. 2923, 57 L.Ed. 932 (1978).

[32] Id.

The claims of the Attorneys General concerning coverage withdrawals are arguably similar to the claims in St. Paul v. Barry. It must be remembered first, however, that St. Paul itself provides support for no more than denial of summary judgment against the Attorneys General. More importantly, there have been many changes in antitrust law and, in particular, in the law relating to summary judgment of antitrust claims in the years since St. Paul.

St. Paul was decided in 1978, just as the Supreme Court began to develop its modern economic efficiency analysis of industrial practices under the antitrust laws.[33] In the intervening years, the Court has much more rigorously defined the prerequisites of an antitrust offense. To establish a violation of the antitrust laws, it must be shown that conspiring defendants have acted in a way to enhance their profits by harming competition.[34]

Very recently, the Supreme Court has clarified the standard for summary judgment of an antitrust claim. In Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,[35] the Court upheld summary judgment in favor of defendants where, despite substantial factual issues concerning the nature of the conspiracy, the acts alleged to violate the antitrust laws would not have increased defendant profits or have harmed competition.

If St. Paul were reanalyzed according to the Matsushita standard, its outcome is not so clear. The allegations of conspiracy, sufficient in 1978, would not be sufficient under Matsushita to support a trial. Most importantly, under Matsushita, it is necessary for complainants to establish that the defendants' actions were economically rational ways to increase their profits by restraining trade. Under Matsushita, the complainants would have to explain why the three other insurers agreed to boycott St. Paul's insureds, forcing them to obtain St. Paul's claims-made coverage. An economically rational firm has no obvious reason to help a competitor retain its clients, not to mention to retain them on terms the clients find unattractive. The incentives of competitors, in fact, are just the opposite. It is puzzling, thus, how the three other conspirators saw to profit from the alleged agreement.

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[33] Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 97 S.Ct. 2549, 53 L.Ed. 2d 568, the case that signalled the beginning of the new approach was decided in 1977.

[34] E.g., Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 97 S.Ct. 690, 50 L.Ed. 2d 701 (1977).

[35] Matsushita Electric Industrial Co., Ltd., v. Zenith Radio Corporation, 475 U.S. 574, 106 S.Ct. 1348, 89 L.Ed. 2d 538 (1986).

Perhaps it could be alleged that St. Paul divided monopoly returns from the shift to claims-made coverage with the other three insurers. But the factual prerequisites of this theory are even more complex. For the scheme to be an economically rational method of maximizing profits, it would be necessary to show 1) that the profit-maximizing output for the industry was exactly equal to St. Paul's insurance capacity (given the withdrawal of the other firms); 2) that insurance delivery was achieved most efficiently by St. Paul alone (thus maximizing industry profits), rather than by some combination of the four; 3) that industry profits were maximized by shifting to claims-made policies, rather than simply by increasing premiums for occurrence policies, the far more typical cartel strategy; and 4) that St. Paul had shared the industry monopoly profits (according to what shares?) with the other three conspirators. It was exactly such a series of implausible factual premises that led the Supreme Court to uphold summary judgment in favor of defendants in Matsushita, especially in contrast to the far simpler and more plausible explanation that the other insurers had withdrawn and St. Paul had shifted to claims-made coverage because of increasing long-tail liability in the medical malpractice line.[36]

More recently, the Supreme Court has considered a case that it characterized as a boycott of consumers in FTC v. Indiana Federation of Dentists.[37] The Federation of Dentists was found guilty of an illegal boycott of consumers. But even in this decision, it is quite clear that, necessary to an offense is the demonstration that the practice at issue increased defendants' profits by means of an artificial interference with market forces, rather than by underlying changes in supply or demand.

The Indiana Federation of Dentists was accused of agreeing to a concerted refusal to supply x-rays to dental insurers wanting to monitor dental insurance claims.[38] It is obvious that the dentists sought to gain supracompetitive returns from the practice, because without x-ray evidence, it would be substantially more difficult for the insurers to deny dentists' claims relating to the provision of dental services. It is also obvious that the refusal to submit x-rays was an artificial interference in market processes. The dentists alleged that x-ray submission led to inferior dental care. But the Court disregarded the argument totally, concluding that there was no credible pro-competitive explanation for the agreement.[39] Thus, again, the two prerequisites of an offense: increase in profits through artificial interference in the market, were easily satisfied.

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[36] See also First National Bank of Arizona v. Cities Service Co., 391 U.S. 253, 88 S.Ct. 1575, 20 L.Ed. 2d 569 (1968) for rejection of a claim of an illegal boycott of consumers on grounds that the boycott "conceivably might also have resulted from a whole variety of non-conspiratorial motives involving the exercise of business judgment." Id. at 391 U.S. 277, 88 S.Ct. 1587.

[37] Federal Trade Commission v. Indiana Federation of Dentists, 476 U.S. 447, 106 S.Ct. 2009, 90 L.Ed. 2d 445 (1986).

[38] The Court characterized the victims of the conspiracy as "consumers", although the seller-customer relationship is complicated because of the third-party claim feature of the case. Strictly, dental patients are the consumers and the insurers are the consumers' agents. The insurers, however, were particularly vulnerable in this case because of existing contracts with patients allowing them the choice of dentist.

[39] 476 U.S. 447 at 459, 465.

How will these current principles of antitrust law be applied to the Attorneys' General suits against the insurers and reinsurers for the alleged concerted withdrawal of pollution, occurrence, and defense cost coverage? It is difficult to see how coverage withdrawals either increase insurer profits or constitute an artificial interference with the market. In contrast, there are strong reasons to believe that the withdrawals were responses to standard market forces of increased supply costs because of the expansion of tort liability. As a consequence, the withdrawals cannot have violated the antitrust laws.

For purposes of discussion, let us accept the allegation that the coverage withdrawls were made in concert. It is not clear factually whether it will be established that pollution, occurrence or defense cost coverage could or could not have been offered at a profit at the time the defendants agreed to withdraw it. Under either factual showing, however, the withdrawals cannot have violated the antitrust laws.

First, if pollution, occurrence, or defense cost coverage could have been offered at a profit, then their withdrawal would have reduced the defendants' profits and increased the profits of the defendants' competitors. In this context, the coverage withdrawals would be economic idiocy, but hardly a restraint of trade. In some contexts it is possible to devise complicated price discrimination theories to explain how changes in the price/quality mix of product characteristics can increase profits. But price discrimination is unlikely in this case, because price discriminating behavior must include charging a price. The withdrawal of pollution, occurrence and defense cost coverage reduces the price/quality opportunities of any seller or group of sellers.

The alternative factual possibility is that pollution, occurrence and defense cost coverage could not have been offered at a profit at the time of the defendants' agreement. The lay impression that the insurance coverage withdrawals increased insurer profits by reducing insurer losses derives from such an estimate. Surely, if the insurers withdrew losing forms of insurance coverage, their losses would decline and their net profits increase.

Withdrawing losing products is probably good business, and it surely increases profits. But it cannot be regarded as an illegal restraint of trade. It cannot be a violation of the antitrust laws to withdraw unprofitable products from markets. If a withdrawal of an unprofitable product were to constitute a boycott, the antitrust laws would stand for the encrustation of industrial obsolescence that would destroy a competitive economy. The manufacturers of stagecoaches, buggywhips or the Edsel did not commit illegal antitrust boycotts by withdrawing losing products because supply costs increased or product demand declined. Similarly, the 47 percent of modern manufacturers did not commit illegal antitrust boycotts by withdrawing unprofitable consumer and industrial products for liability reasons.[40] It can be no more of an antitrust offense for an insurer or group of insurers to withdraw unprofitable forms of insurance coverage.

Again, the strongest evidence in the case, described in the preceding Part, is that, far from artificial, the insurance coverage withdrawals were responses to underlying changes in insurance supply costs because of the expansion of tort liability. Most persuasive are the parallel responses of self- and non-insured entities, subject to the same expansion of liability.

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[40] E. Patrick McGuire, The Impact of Product Liability at 20, Table 30 (Conf. Bd. 1988).

But when the evidence of the crisis is examined in aggregate:

1) the irrefutable expansion of tort liability creating long tails of exposure in exactly the fields affected by the coverage withdrawals;

2) the parallel responses of the self-insured to the expansion of tort liability; and

3) the strong advantages of segregating polluters and other entities generating long liability tails from other commercial insureds;

it provides a powerful pro-competitive explanation for the withdrawal of pollution, occurrence and defense cost coverage. When added to the demonstration that the insurers could not have profited from the coverage withdrawals, there is very little chance that the Attorneys General can establish restraint of trade.[41]

For these reasons, I believe that the coverage withdrawals do not constitute an antitrust violation. Where there is no violation of the antitrust laws, the McCarran-Ferguson exemption from antitrust liability (as well as the Act's Section 3(b) exception) is irrelevant. Most importantly, for this Committee, the lawsuits are irrelevant to the Senate's consideration of the McCarran-Ferguson Act.

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[41] I have not alluded to the substantial evidence from insurance industry accounts confirming extraordinary increases in long-tail liability costs in the lines from which coverage was withdrawn. For a review, see Scott E. Harrington, Prices and Profits in the Liability Insurance Market, in Liability Perspectives and Policy at 42 (Litan and Winston eds. 1988).

Senator **Metzenbaum**. Our next witnesses are Thomas J. Coyne, Jr., mayor of the City of Brook Park, OH, a fine community near where I live; Lila Coughran, executive director, Texas Easter Seal Society, Austin, TX; Louis Grumet, executive director of the New York State School Boards Association, Albany, NY; and Gerald Moody, town counsel, town of Milford, Milford, MA

We have allocated 5 minutes for each of you; if you can do it in four, it will save the Chairman some problems as well as the other member of the committee. But please proceed.

Mayor Coyne, you are our first witness. We are very happy to welcome you here.

STATEMENT OF A PANEL, INCLUDING: HON. THOMAS J. COYNE, JR., MAYOR, CITY OF BROOK PARK, OH, ACCOMPANIED BY DAVE MADDOX, MANAGING PARTNER, LAW FIRM OF ARTER AND HADDEN; LILA COUGHRAN, EXECUTIVE DIRECTOR, TEXAS EASTER SEAL SOCIETY, AUSTIN, TX; LOUIS GRUMET, EXECUTIVE DIRECTOR, NEW YORK STATE SCHOOL BOARDS ASSOCIATION, ALBANY, NY; AND GERALD MOODY, TOWN COUNSEL, TOWN OF MILFORD, MA

Mayor **Coyne**. Thank you, Mr. Chairman. We in Ohio always believe in expeditiously moving along in these hearings, and we will move along very quickly.

I would first like to thank the members of this subcommittee personally and on behalf of the citizens of Brook Park, OH for giving me the opportunity to appear before you today.

Accompanying me today is Dave Maddox, the managing partner of the Washington, D.C. office of the Cleveland law firm of Arter and Hadden. He, along with Tom McDonald and Shelly Goering, represent the City of Brook Park in pending litigation in the Federal district court in Cleveland and in the Franklin County Court of Common Pleas in Columbus, regarding the city's insurance coverage.

I congratulate the subcommittee for deciding to hold this hearing and endorse your inquiry into the conduct which precipitated the recent municipal insurance crisis. I would also like to applaud those attorneys general who have testified today, as well as those who are participating in the insurance antitrust litigation which is the subject of this hearing.

Finally, I would like to thank Senator Metzenbaum for calling this hearing and once again demonstrating his concern for local governments in Ohio and across the country.

The recent contrived municipal insurance crisis is a problem of national scope. I was appalled to read the article in the Washington Post and elsewhere regarding the antitrust litigation pending in San Francisco and Texas and realized that the city of Brook Park is just one example of how cities across the country have suffered.

My purpose in appearing before you today is to tell you what happened in my city. I am the mayor of the city of Brook Park, OH. Brook Park is a working class suburb of Cleveland with approximately 25,000 residents. Beginning in 1985, the city was faced with either losing its insurance coverage altogether or undergoing severe financial hardship to pay for minimal coverage.

In the fall of 1984, we began to ~~look for~~ municipal insurance coverage. Working through our insurance consultant, we obtained coverage from National Union Fire Insurance Company of Pittsburgh, PA, a member company of the American International Group. National Union's managing general agent for our policies was Marinco, Incorporated in San Antonio, TX. We purchased two insurance policies from National Union, a package policy including liability and buildings and an automobile policy.

The policies issued to us were three-year policies which became effective on December 31, 1984. These policies were written on an occurrence basis. The combined premium for these policies during the first policy year was $181,700. It was our understanding when we purchased these policies that our premium would increase in subsequent years only if insurance rates filed with the Ohio Department of Insurance increased and if the specific loss experience of the city warranted an increase.

Because the policies were three-year policies, we reasonably expected that we would have coverage until December 31, 1987. However, in October of 1985, when our coverage had only been in effect for 10 months, we were notified that our policies were being cancelled at the end of the first policy year for "underwriting reasons". We were given no other reason for this sudden and unjustified cancellation. In fact, an underwriting inspection conducted by Marinco in May of 1985 showed that the city was in fact a fine account.

Also in October of 1985, the Governor of the State of Ohio, Richard Celeste, issued an emergency rule prohibiting mid-term policy cancellation. We asked for the help of the Ohio Department of Insurance, which found that the attempted cancellation of our policies would have violated this rule. Because of this finding, National Union agreed to rescind the notice of cancellation.

After the notice of cancellation was rescinded, Brook Park continued to be insured on an occurrence basis, and we thought our insurance problems were resolved. However, we soon realized that our problems had just begun. Through Marinco, National Union notified us that our premium for the second policy year was being increased from $181,700 to $607,178, and that our deductibles were also being increased. We were given no reason for this premium increase of over 340 percent. Not only was this premium unjustified given the city's loss history and the fact that we were considered a good risk, but it was calculated using rates not on file with the Ohio Department of Insurance.

Brook Park was completely unprepared for a premium increase of this size. We were unable to pay the premium demanded and faced the possibility that the city would be left with no insurance coverage whatsoever if our policies were cancelled for non-payment of premiums.

Senator METZENBAUM. Mayor, can you summarize the balance of your testimony, please?

Mayor COYNE. Okay. Basically, Senator, what we are saying is the fact of the matter is the State regulation is really not enough. As the end result of this, basically, the Department of Insurance found that they had not filed the proper rates; they ordered them to pay for the expense of the proceedings and basically told them to file justification for new rates.

So basically, local governments are in the business of government for providing services, and basically, the actions of the insurance company has made that increasingly more difficult.

Senator **METZENBAUM**. Did the insurance company comply, and did the insurance commissioner's action provide sufficient help for you?

Mayor **COYNE**. It did immediately, Senator, because they found that they had violated the Governor's rule of cancelling the policy in mid-term. However, what they did was raise our rates 340 percent, making it impossible for the city to pay the premiums.

Senator **METZENBAUM**. And you had to pay the additional 240 percent?

Mayor **COYNE**. We did not do that. We filed a bond in Federal Court so that the insurance would continue pending the litigation and the decision.

Senator **METZENBAUM**. And that has not as yet been resolved?

Mayor **COYNE**. No, sir, that has not.

Senator **METZENBAUM**. Thank you very much, Mayor Coyne. Your testimony is extremely helpful. I am happy to have you with us and happy to see you again personally.

Mayor **COYNE**. Thank you, Senator.

[Statement of Mayor Coyne follows:]

OPENING STATEMENT

By The Honorable Thomas J. Coyne, Jr.,
Mayor of the City of Brook Park, Ohio
Before the Subcommittee on Antitrust,
Monopolies and Business Rights
Of The Senate Judiciary Committee

I would first like to thank the members of this Subcommittee, personally and on behalf of the citizens of Brook Park, Ohio, for giving me the opportunity to appear before you today. Accompanying me is Dave Maddox, Managing Partner of the Washington, D.C. office of the Cleveland law firm of Arter & Hadden. He, along with Tom McDonald and Shelly Goering, represent the City of Brook Park in litigation pending in Federal District Court in Cleveland and in the Franklin County Court of Common Pleas in Columbus regarding the City's insurance coverage. I congratulate the Subcommittee for deciding to hold this hearing and endorse your inquiry into the conduct which precipitated the recent municipal insurance crisis. I would also like to applaud those Attorneys General who have testified today, as well as those who are participating in the insurance antitrust litigation which is the subject of this hearing. Finally, I would like to thank Senator Metzenbaum for calling this hearing and once again demonstrating his concern for local governments in Ohio and across the country.

The recent municipal insurance crisis is a problem of national scope. I was appalled to read the article in The Washington Post and elsewhere regarding the antitrust litigation pending in San Francisco and Texas, and realized that the City of Brook Park is just one example of how cities across the country have suffered. My purpose in appearing before you today is to tell you what happened in my city.

I am the Mayor of the City of Brook Park, Ohio. Brook Park is a working class suburb of Cleveland with approximately 25,000 residents. Beginning in 1985, the City was faced with either losing its insurance coverage all together or undergoing severe financial hardship to pay for minimal coverage.

In the fall of 1984, we began to look for municipal insurance coverage. Working through our insurance consultant, we obtained coverage from the National Union Fire Insurance Company of Pittsburgh, Pa., a member company of the American International Group. National Union's managing general agent for our policies was Marinco, Inc., in San Antonio, Texas. We purchased two insurance policies from National Union, a general liability policy and an automobile policy.

The policies issued to us were three-year policies, which became effective on December 31, 1984. The policies were written on an occurrence basis. The combined premium for the policies during the first policy year was $~~178,130.00.~~ $171,700.00 It was our understanding when we purchased these policies that our premium would increase in subsequent years only if insurance rates filed with the Ohio Department of Insurance increased, and if the specific loss experience of the city warranted an increase.

Because the policies were three-year policies, we reasonably expected that we would have coverage until December 31, 1987. However, in October of 1985, when our coverage had only been in effect for 10 months, we were notified that our policies were being cancelled at the end of the first policy year for "underwriting reasons." We were given no other reason for this sudden and unjustified cancellation. In fact, an underwriting inspection conducted by Marinco in May of 1985 showed that the City was in fact a good risk.

Also in October of 1985, the Governor of the State of Ohio issued an emergency rule prohibiting mid-term policy cancellation. We asked for the help of the Ohio Department of Insurance, which found that the attempted cancellation of our policies would have violated this rule. Because of this finding, National Union agreed to rescind the notice of cancellation.

After the notice of cancellation was rescinded, Brook Park continued to be insured on an occurrence basis, and we thought our insurance problems were resolved. However, we soon realized that our problems had just begun. Through Marinco, National Union notified us that our premium for the second policy year was being increased from 181,700. ~~$178,130~~.00 to $607,178.00, and that our deductibles were also being increased. We were given no reason for this premium increase of over 340%. Not only was this premium unjustified given the City's loss history and the fact that we were considered a good risk, but it was calculated using rates not on file with the Ohio Department of Insurance.

Brook Park was completely unprepared for a premium increase of this size. We were unable to pay the premium demanded, and faced the possibility that the City would be left with no insurance coverage whatsoever if our policies were cancelled for nonpayment of premiums. The City was in a crisis situation, and something had to be done to prevent National Union from cancelling our coverage.

We complained to the Ohio Department of Insurance, because we were being charged premiums based on rates far in excess of lawful rates on file with the Department. We also filed a declaratory and injunctive action in court, seeking to maintain the policies in full force and effect. The Federal District Court in Cleveland allowed us to pay $181,700.00 of the premium to National Union and to post a bond for the remainder, pending the outcome of the complaint before the Insurance Department. The court also ordered National Union to maintain the policies in full force and effect until December 31, 1986.

The Ohio Department of Insurance conducted an investigation and hearing to determine whether National Union violated Ohio law by charging premiums calculated with rates not on file with the Department. On January 5, 1987, the Department found that the premiums charged were unlawful. The company has appealed this finding, and this appeal is pending.

When the second policy year ended on December 31, 1986, National Union quoted the third year. They offered only a claims made policy with a premium of $812,000.00. We declined this coverage. We searched for other coverage, but soon realized that the municipal insurance market had dried up. We could not find reasonable coverage at a reasonable price. Few companies were writing municipal insurance policies, and those that were offered only claims made coverage. For example, one municipal insurance broker offered us an extremely limited claims made policy with a $250,000 deductible.

Because we could not get other coverage, we established a program of self-insurance. We also expanded our litigation in Federal District Court in Cleveland regarding National Union and Marinco's treatment of the City.

The drastic increase in premiums, the threat of being totally without coverage and the need to establish a self-insurance fund have had a tremendous impact on my city. When we were negotiating for the policies, we were told that the City was a good risk. The City was inspected in May of 1985, and no recommendations to minimize risk exposures were made. At that time, Marinco considered us "a fine account."

As I indicated earlier, the second year premium increased 340%. Had we not been permitted to post a bond for over $400,000 of this premium, the City would have lost its coverage beginning January 1, 1985, I would have had to drastically cut or eliminate many city services and the City would have been at risk. Fortunately, we were able to maintain coverage. However, a second underwriting inspection was conducted in April of 1986, less than a year after the City was told we were a fine account. This time, almost 30 recommendations to minimize risk exposures were made, including closing down three playgrounds.

The self-insurance fund has also created difficulties for the City. We established this fund because National Union would provide coverage during 1987 only on a claims made basis for the arbitrary and unreasonable premium of $812,000. In addition, affordable municipal coverage was not available elsewhere.

This fund is financed with monies from our general operating fund. Over a five-year period, $1.4 million is being put into this fund. These monies would otherwise be used for capital improvements, road maintenance and repair, recreational facilities, and other services which contribute to the high quality of life in Brook Park. A judgment in excess of the fund would also require the City to issue judgment bonds or divert even more funds from the general operating budget.

I realize that the City of Brook Park is not alone in facing the realities of the municipal insurance crisis. My purpose today has been to tell you how my City has suffered, as I'm sure cities across the country have suffered. I am not here to seek special treatment for my City, but I believe that the City of Brook Park provides an example of how the quality of life of citizens nationwide has been affected by this crisis. Insurance is good and an absolute necessity for any public or private entity to operate, but arbitrary terminations of coverage should not be allowed and the spiraling increase in premiums should be controlled.

Again, thank you for giving me the opportunity to appear before you today. Mr. Maddox and I would now be happy to address your questions.

OHIO
PUBLIC
INTEREST
CAMPAIGN

[illegible]

6/9/88

Senator Howard Metzenbaum
140 Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Metzenbaum:

We commend you and the Senate Sub-committee on Anti-trust, Monopolies and Business Rights for holding these hearings on the liability insurance crisis.

The Ohio Public Interest Campaign, the largest consumer organization in Ohio with over 350,000 members, was very involved in the liability crisis issues in Ohio. Our assessment of the considerable evidence available was that the crisis was by and large a conscious and orchestrated response by the liability insurance industry to raise prices and reduce coverage to recover from the consequences of price war underpricing and collapsing interest rates. The "lawsuit crisis" formulation and "tort reform" bills were a creative and all too successful deception - addressing the long term political agenda of the insurance industry and big business by selling legislatures the wrong diagnosis and wrong treatment for crisis.

The recent suit by states attorneys general against elements of the liability insurance industry alleging violations of anti-trust law raises, we think, very important questions about the conduct of that industry and the sufficiency of present law. We think it is of critical importance that this committee inquire into these issues.

We are writing to bring to the attention of the Committee a study done in 1986, at the height of the crisis, by our research affiliate, the Industrial States Policy Center. The study, entitled The Ohio Social Service and School District Liability Insurance Survey, was based on a statewide survey of 239 social service providers and school districts in Ohio. They were chosen as a cross section of this organizational sector from Ohio's major cities.

Seventy-six percent of the organizations responding had experienced liability rate increases in the previous three years. Most of the ones that did not experience these increases were either newly established or covered by the policy of an umbrella agency. Of those experiencing an increase, the average rate increase was 67% for 1984-1985 and 58% from 1985 through the

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Dayton, Ohio 45402
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[illegible]
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first six months of 1986. Thirty percent of the respondents reported that their insurance coverage was reduced from the previous year and a full 28% had their insurance policies canceled during the previous 18 months.

Yet the evidence showed that these were hardly risky businesses. Seventy percent of the respondents had never had a claim against their liability policy, and 80% had never had a cash settlement of any type. In fact, as a group the respondents reported claims against them over the previous three years that amounted to less than $270,000 while they paid a total of more than $7,000,000 in premiums during the same period.

On the face of it these data must raise grave questions as to whether a free market in liability insurance in fact existed in Ohio during these years.

Unfortunately, the legislative legacy of the liability crisis to this point has very largely been varieties of "tort reform" legislation. No one these days argues that this legislation is likely to affect insurance rates, and no one argues that it will have any effect on preventing or moderating the next insurance crisis. The next crisis can only be prevented by returning real competition and anti-trust prohibition to the insurance industry together with more rigorous financial reported and regulation of that industry. Ohio cannot afford and the country cannot afford to go through this again.

Sincerely,

Peter MacDowell
Legislative Director

Final Report of the
OHIO SOCIAL SERVICE AND SCHOOL DISTRICT
LIABILITY INSURANCE SURVEY

Prepared by:

Ohio Public Interest Campaign

Based on a survey conducted by:

Industrial States Policy Center

July, 1986

INTRODUCTION AND BACKGROUND

Within the last two years, liability insurance has gone from being a routine aspect of running a social service agency/school district to a major crisis that has gripped the entire field. Throughout the past year there have been increasing reports in the media about social service agencies and school districts whose liability policies have been cancelled or not renewed, whose rates have more than doubled or whose coverage has been cut-back dramatically.

The insurance industry has increased rates and eliminated from coverage numerous lines of business considered "risky," or more appropriately, unprofitable. Social service agencies and school districts have been included among the industry's list of unprofitable businesses.

The burden has been placed on the social service sector and school districts to document the scope of the problem and to assess the allegations by the insurance industry that social service agencies and schools warrant classification as a high risk business.

In this climate of fear and uncertainty, there is a criticial need for a statewide survey of social service agencies and school districts.

THE ISPC SURVEY

In May, surveys were mailed to a statewide sample of social service agencies and school districts. The survey assessed recent changes in the availability, affordability, and coverage agencies and districts have experienced with their liability insurance. Respondents also reported their entire history of insurance claims, and their plans for coping with their insurance problems.

Two hundred thirty-nine surveys were returned, producing a 31 percent return rate. Surveys were completed by providers throughout Ohio, thus giving the results a statewide scope. The types of organizations represented in this report are detailed in Table #1.

TABLE # 1

SURVEY RESPONDENTS

Organization	Number Returned
Drug/alcohol Services	5
Community Action Agencies	5
Child/Youth Services	19
Community Centers/multipurpose	19
Daycare/nursery	30
Disabled Services/Gp Homes	19
Educational Groups	3
Food/Hunger Centers	4
Health Agencies/Services	9
Housing Services/Authorities	3
Mental Health Agencies	11
Schools-Private	5
Recreational Facilities	3
School Districts	55
Senior Centers/Services	7
Social Service- General Agencies	25
Women's Agencies/Services	7
Family Services	4
Miscellaneous Agencies	6
TOTAL:	239

The respondents represented child/youth agencies; daycare; mental health services; disabled services; community centers and school districts. Thus where results are reported in the aggregate the results are somewhat overrepresented by school districts.

MAJOR FINDINGS

Insurance Profile

The majority of social service programs and school districts have routinely been covered by liability insurance. Ninety-three percent of the survey respondents have had liability coverage during the last few years. Thirty percent were required by the federal /state or local government to maintain liability insurance as a condition of receiving funds.

Again, the majority of respondents had "Officers and Directors" insurance. Eighty percent of the survey respondents reported maintaining this type of liability insurance.

Frequency and Amount of Rate Increases

Seventy-six percent of the respondents have experienced a rate increase during the last three years. Of those reporting no increase the vast majority were newly established organizations or organizations who had found coverage through an umbrella agency.

The average statewide liability insurance increase from 1984-1985 was 67 percent, while the average increase from 1985 through the first six months of 1986 was 58 percent. Various types of organizations experienced a wide range of increases (See Table #2).

During 1984-1985, Child/youth organizations had an average 75 percent liability insurance rate increase while general Social Service providers had a 22percent increase. During 1985-1986, Women's Agencies reported a 275% increase in liability insurance while School Districts had a 29 percent increase.

TABLE # 2

ORGANIZATIONAL RATE INCREASES

(1984-1986)

Organization	'84-'85 % increase	'85-'86 % increase
Child/Youth Services	75%	53%
Community centers/multipurpose	55%	55%
Daycare/nursery	50%	47%
Disabled Services/Gp Homes	53%	46%
Family Services	32%	86%
Health Agencies/Services	31%	41%
Mental Health Agencies	57%	78%
School Districts	57%	29%
Senior Centers/Services	-	48%
Social Service	22%	122%
Women's Agencies/Services	79%	275%
*STATEWIDE TOTAL:	67%	58%

Liability insurance rate increases varied depending on what area of the state respondents were from. For instance, for the 1984-1985 period Cincinnati respondents experienced a 93 percent increase while Columbus respondents experienced a 29 percent increase. From 1985 - 1986 Cincinnati once again reported the highest rate increase-91 percent while Canton reported a 24 percent increase (See Table # 3 for complete breakdown) in liability insurance rates.

TABLE # 3

GEOGRAPHIC RATE INCREASES

(1984 - 1986)

Region	'84-'85 % increase	'85-'86 % increase
Akron Metro	82%	51%
Southeast Ohio	78%	34%
Canton Metro	83%	24%
Cincinnati Metro	93%	91%
Cleveland Metro	62%	42%
Columbus Metro	29%	52%
Dayton Metro	83%	75%
Toledo Metro	50%	48%
*STATEWIDE TOTAL:	67%	58%

Forty-seven percent of respondents in 1984-1985 and the same number in 1985- 1986, had a greater than 50% increase in their liability insurance rate. The trend does not seem to be abating substantially.

Changes in Coverage

Despite the higher rates that most programs are now paying for liability insurance, the extent of coverage is diminishing. Thirty percent of survey respondents reported that their insurance coverage was narrower than it had been last year.

In addition, 28 percent of the respondents had had their policy cancelled during the last eighteen months. Only 6 percent had experienced any midterm premium increases.

Claims History and Comparison to Premiums Paid

Despite the insurance industry's characterization of social service and school districts as a risky business, the survey results provide ample evidence to the contrary. The respondents reported very few claims and the vast majority of those reported were under $2,000.

Seventy percent of survey respondents had never had a claim against their liability insurance policy. In addition, eight out of ten respondents had never had an actual cash settlement of any type.

Of those with claims, the average settlement was $5,900. There were only four "high awards" of $55,000; two for $30,000 and $21,000 respectively. Of more significance was the mean settlement award-$2,600.

Total claims reported by survey respondents (and paid out by their insurance)amounted to $269,660, compared to total premiums paid for 1984- 1986 of $7,016,749. Thus, non-profits and school districts produced total claims amounting to 4 percent of the premiums they paid in the last three years.

Planned Responses of Social Service Agencies and School-Districts

Most survey respondents are making efforts to maintain some liability coverage despite the hardships associated with unavailability and unaffordability of liability insurance. Overall, only 13 percent of respondents were considering going without insurance. Thirty-two percent were considering reducing the amount of coverage they purchased or increasing the deductibles in their policies.

A number of respondents were reviewing the possibility of risk pooling with other agencies. While many were attempting to obtain umbrella coverage through a national sponsor.

APPENDIX A

ORGANIZATIONAL SURVEY RESULTS

(1984 -1986 COSTS)

ORGANIZATION TYPE 1,2,3,4,5,6,7,8	QUEST 3b 1985 COST	QUEST 3b 1986 COST	PERC. INCR. 85-'86
STATE TOTALS:	2,172,829	3,436,820	58%
COMMUNITY CENTER/AGENCY TOTALS:	37,709	58,610	55%
Community Center -2,4,8			
Community Center -2,5,8			
Community Center -multipurp. 1,2,3,4,8	5,400	8,904	65%
Community Center, daycare, rec-1,2,4	16,867	26,369	56%
Community Center-2,3,5			
Community Econ. Devlp-5	998	1,768	77%
Community Econ. Devlp-5,8	3,000	3,000	0%
Community House- 2,8	1,225	2,400	96%
Community Org -8	500	1,750	250%
Community multi-purpose -8			
Community, Reg. Devl Dist. -5,8	650	1,800	177%
Community, multipurpose -1,2,3			
Community, multipurpose -3,5,6	1,519	2,219	46%
Community- multipurpose1,2,4,5,8	2,800	2,800	0%
Community-multi purpose-1,2,3,4,5,7,8	750	4,000	433%
Community-multiporpose-1,2,3,4,5	4,000	3,600	-10%
Community-multipurpose, 2,4,8			

	1984 COST	1985 COST	PERC. INCR. 84-'85
STATE TOTALS:	1,407,100	2,344,075	67%
COMMUNITY CENTER/AGENCY TOTALS:	15,879	24,617	55%
Community - multipurpose; 3,5,7	2,865	4,450	55%
Community Center -2,4,8	329	500	52%
Community Center -multipurp. 1,2,3,4,8	3,360	5,400	61%
Community Center-2,3,5	250	550	120%
Community Econ. Devlp-5	710	998	41%
Community Econ. Devlp-5,8	3,000	3,000	0%
Community, Reg. Devl Dist. -5,8	650	650	0%
Community, multipurpose -3,5,6	840	1,519	81%
Community- multipurpose1,2,4,5,8	2,450	2,800	14%
Community-multi purpose-1,2,3,4,5,7,8	725	750	3%
Community-multiporpose-1,2,3,4,5	700	4,000	471%

ORGANIZATION TYPE 1,2,3,4,5,6,7,8	QUEST 3b 1985 COST	QUEST 3b 1986 COST	PERC. INCR. 85-'86
STATE TOTALS:	2,172,829	3,436,820	58%
DAYCARE TOTALS:	22,062	32,401	47%
Day Care Center 1	2,266	2,993	32%
Day care -1	1,500	3,470	131%
Day care, referrals -1	334	490	47%
Daycare -1	7,516	11,196	49%
Daycare - 1	900	1,200	33%
Daycare -1	809	809	0%
Daycare -1			
Daycare -1			
Daycare -1	1,300	1,300	0%
Daycare -1	235	1,000	326%
Daycare -1	1,100	1,100	0%
Daycare -1			
Daycare -1	95	95	0%
Daycare -1	800	800	0%
Daycare -1	307	928	202%
Daycare -1			
Daycare -1			
Daycare -1			
Daycare -1	1,200	2,870	139%
Daycare -1			
Daycare -1	1,500	1,500	0%
Daycare -1			
Daycare -1			
Daycare-1	600	850	42%
Daycare-1			
Daycare-1	1,600	1,800	13%
Daycare/camp -1,8			
Daycare/nursery scho-1			

	1984 COST	1985 COST	PERC. INCR. 84-'85
STATE TOTALS:	1,407,100	2,344,075	67%
DAYCARE TOTALS:	10,993	16,444	50%
Day Care Center 1	1,440	2,266	57%
Day care, referrals -1	203	334	65%
Daycare -1	5,676	7,516	32%
Daycare - 1	800	900	13%
Daycare -1	800	800	0%
Daycare -1	500	1,500	200%
Daycare -1	307	307	0%
Daycare -1	95	95	0%
Daycare -1	200	809	305%
Daycare -1	737	1,682	128%
Daycare -1	235	235	0%

ORGANIZATION TYPE 1,2,3,4,5,6,7,8	QUEST 3b 1985 COST	QUEST 3b 1986 COST	PERC. INCR. 85-'86
STATE TOTALS:	2,172,829	3,436,820	58%
DISABLED SERVICES/AGENCY TOTALS:	146,957	214,436	46%
Disabled Center -4,8	4,211	5,339	27%
Disabled Group Homes -3,7,8	990	3,179	221%
Disabled Group Homes -8		3,400	
Disabled Reside/treatment -3,8	5,027	1,729	-66%
Disabled Residential services -8	7,228	29,408	307%
Disabled Services -3,8	11,137	12,200	10%
Disabled Services -7,8	5,000	6,000	20%
Disabled Services -7,8	17,907	15,143	-15%
Disabled Social SErvice - 8	2,695	4,250	58%
Disabled Social Service -8			
Disabled Social Service -8	17,581	21,984	25%
Disabled housing/services -8		500	
Disabled residential Services-8	5,600	10,800	93%
Disabled services (ment. retarded) -8	2,000	15,000	650%
Disabled social services -8			
Disabled, devl services -8	6,000	6,500	8%
Disabled, social service -8	20,600	28,075	36%
Disabled, voc rehabiliation 7,8	30,281	38,129	26%
Disabled/Senior Transp Service -8	10,700	12,800	20%

	1984 COST	1985 COST	PERC. INCR. 84-'85
STATE TOTALS:	1,407,100	2,344,075	67%
DISABLED SERVICES/AGENCY TOTALS:	74,798	114,129	53%
Disabled Center -4,8	2,398	4,211	76%
Disabled Group Homes -3,7,8	698	990	42%
Disabled Reside/treatment -3,8	3,325	5,027	51%
Disabled Services -3,8	3,714	11,137	200%
Disabled Services -7,8	11,464	17,907	56%
Disabled Social SErvice - 8	1,428	2,695	89%
Disabled Social Service -8	17,774	17,581	-1%
Disabled residential Services-8	4,900	5,600	14%
Disabled services (ment. retarded) -8	2,000	2,000	0%
Disabled, devl services -8	5,500	6,000	9%
Disabled, voc rehabiliation 7,8	16,597	30,281	82%
Disabled/Senior Transp Service -8	5,000	10,700	114%

ORGANIZATION TYPE 1,2,3,4,5,6,7,8	QUEST 3b 1985 COST	QUEST 3b 1986 COST	PERC. INCR. 85-'86
STATE TOTALS:	2,172,829	3,436,820	58%
FAMILY AGENCY TOTALS:	24,708	45,863	86%
Family Counseling/Services			
Family Services -8	5,000	10,087	102%
Family Services -8	7,979	15,351	92%
Family planning -8	11,729	20,425	74%

	1984 COST	1985 COST	PERC. INCR. 84-'85
STATE TOTALS:	1,407,100	2,344,075	67%
FAMILY AGENCY TOTALS:	19,207	25,261	32%
Family Counseling/Services	888	553	-38%
Family Services -8	2,578	5,000	94%
Family Services -8	4,497	7,979	77%
Family planning -8	11,244	11,729	4%

ORGANIZATION TYPE I,2,3,4,5,6,7,8	QUEST 3b 1985 COST	QUEST 3b 1986 COST	PERC. INCR. 85-'86
STATE TOTALS:	2,172,829	3,436,820	58%
HEALTH SERVICE/CARE AGENCY TOTALS:	9,920	13,994	41%
Health Care Agency -8	2,687	4,901	82%
Health Dept. -8			
Health Dept. -8	5,400	6,100	13%
Health SErvices Agency -8			
Health Services Agency -8	83	83	0%
Health Services Agency -8			
Health Services Agency -3	900	1,400	56%
Health Services Agency -8	150	410	173%
Health care service agency-8	700	1,100	57%

	1984 COST	1985 COST	PERC. INCR. 84-'85
STATE TOTALS:	1,407,100	2,344,075	67%
HEALTH SERVICE/CARE AGENCY TOTALS:	7,062	9,220	31%
Health Care Agency -8	2,687	2,687	0%
Health Dept. -8	2,450	5,400	120%
Health SErvices Agency -8	892		-100%
Health Services Agency -8	83	83	0%
Health Services Agency -3	800	900	13%
Health Services Agency -8	150	150	0%

ORGANIZATION TYPE 1,2,3,4,5,6,7,8	QUEST 3b 1985 COST	QUEST 3b 1986 COST	PERC. INCR. 85-'86
STATE TOTALS:	2,172,829	3,436,820	58%
MENTAL HEALTH AGENCY/SERVICE TOTALS:	55,273	98,357	78%
Mental Health -outpatent & resident-8	7,991	12,777	60%
Mental Health Agency -1,3	4,584	5,961	30%
Mental Health Board	1,491	2,941	97%
Mental Health Board -8	2,270	4,500	98%
Mental Health Center -8			
Mental Health Center/Housing -8	24,000	40,000	67%
Mental Health Counseling-8			
Mental Health Services -8	2,756	3,680	34%
Mental Health center -8	8,500	17,000	100%
Mental Health residen/job training -8	3,681	11,498	212%
Mental Health, group homes -8			

	1984 COST	1985 COST	PERC. INCR. 84-'85
STATE TOTALS:	1,407,100	2,344,075	67%
MENTAL HEALTH AGENCY/SERVICE TOTALS:	52,692	82,521	57%
Mental Health -outpatent & resident-8	6,463	7,991	24%
Mental Health Agency -1,3	4,114	4,584	11%
Mental Health Board	683	1,491	118%
Mental Health Center -8	2,200	6,673	203%
Mental Health Center/Housing -8	12,000	24,000	100%
Mental Health Counseling-8	10,643	16,928	59%
Mental Health Services -8	3,500	2,756	-21%
Mental Health center -8	5,000	8,500	70%
Mental Health reside/treatment/job train-7,8	3,589	3,681	3%
Mental Health, group homes -8	4,500	5,917	31%

ORGANIZATION TYPE 1,2,3,4,5,6,7,8	QUEST 3b 1985 COST	QUEST 3b 1986 COST	PERC. INCR. 85-'86
STATE TOTALS:	2,172,829	3,436,820	58%
SCHOOL TOTALS:	1,357,104	1,746,147	29%
School Distrct -6			
School Distrct -8			
School District .6	1,580	2,310	46%
School District -6	4,895	8,214	68%
School District 6			
School District -6	7,088	8,151	15%
School District -6	142,378	197,548	39%
School District -1,4,6	8,000	9,500	19%
School District -6	2,188	4,626	111%
School District -6	12,911	12,911	0%
School District -6	4,500	5,313	18%
School District -6	9,457	15,000	59%
School District -6	730,000	835,000	14%
School District -6	12,325	17,718	44%
School District -6	9,180	10,800	18%
School District -6			
School District -6			
School District -6	4,000	8,000	100%
School District -6			
School District -6	13,860	22,116	60%
School District -6	7,661	13,000	70%
School District -6	4,100	4,800	17%
School District -6	5,105	7,387	45%
School District -6	1,100	4,580	316%
School District -6	9,123	13,152	44%
School District -6	1,964	3,406	73%
School District -6	5,442	6,406	18%
School District -6			
School District -6	300	1,040	247%
School District -6	12,000	22,000	83%
School District -6	18,086	22,612	25%
School District -6	1,132	2,195	94%
School District -6	7,000	10,000	43%
School District -6	16,000	28,000	75%
School District -6	1,124	1,544	37%
School District -6	1,889	2,724	44%
School District -6	13,095	9,849	-25%
School District -6	2,100	2,500	19%
School District -6	7,300	7,800	7%
School District -6			
School District -6	60,000	125,000	108%
School District -6	5,591	7,680	37%
School District -6	3,105	3,582	15%
School District -6	5,362	7,725	44%
School District -6	2,734	3,152	15%
School District -6	7,618	9,674	27%
School District -6	5,200	6,400	23%
School District -6	2,200	3,350	52%

ORGANIZATION TYPE 1,2,3,4,5,6,7,8	QUEST 3b 1984 COST	QUEST 3b 1985 COST	PERC. INCR. 84-'85
STATE TOTALS:	1,407,100	2,344,075	67%
SCHOOL TOTALS:	937,386	1,472,547	57%
School District 6	1,062	1,580	49%
School District -6	4,625	4,895	6%
School District 6	2,010	2,772	38%
School District -6	5,155	7,088	37%
School District -6	99,413	142,378	43%
School District -1,4,6	6,000	8,000	33%
School District -6	6,635	9,123	37%
School District -6	1,147	1,964	71%
School District -6	10,522	18,086	72%
School District -6	14,000	16,000	14%
School District -6	4,000	7,000	75%
School District -6	463,992	730,000	57%
School District -6	2,608	5,362	106%
School District -6	4,737	15,846	235%
School District -6	734	1,132	54%
School District -6	5,573	12,911	132%
School District -6	6,101	9,457	55%
School District -6	10,278	13,860	35%
School District -6	3,121	3,105	-1%
School District -6	21,000	60,000	186%
School District -6	4,118	13,095	218%
School District -6	1,000	2,734	173%
School District -6	5,563	9,180	65%
School District -6	3,338	7,618	128%
School District -6	1,100	2,200	100%
School District -6	1,557	2,188	41%
School District -6	1,240	1,806	46%
School District -6	1,800	4,500	150%
School District -6	12,000	12,000	0%
School District -6	300	300	0%
School District -6	3,000	4,100	37%
School District -6	640	1,124	76%
School District -6	3,957	5,442	38%
School District -6	2,189	5,659	159%
School District -6	3,713	5,105	37%
School District -6	3,800	7,300	92%
School District -6	3,000	4,000	33%
School District -8	10,496	13,481	28%
School District- 6	16,000	24,000	50%
School District- 6	6,117	15,630	156%
School District-6	125,500	144,281	15%
School, College -8	45,000	90,000	100%
School, Private 1,6	245	245	0%
School, private -6	9,000	26,000	189%

ORGANIZATION TYPE 1,2,3,4,5,6,7,8	QUEST 3b 1985 COST	QUEST 3b 1986 COST	PERC. INCR. 85-'86
STATE TOTALS:	2,172,829	3,436,820	58%
SENIOR SERVICES/CENTER TOTALS:	24,781	36,725	48%
Senior Center -2,4,8	363	1,700	368%
Senior Center plus 1,2,4,5,7	20,255	29,386	45%
Senior Center-4,8	600	600	0%
Senior Centers -8			
Senior Daycare -1			
Senior Social Service-2,4,8	3,394	4,870	43%
Senior/Social Service	169	169	0%

ORGANIZATION TYPE 1,2,3,4,5,6,7,8	QUEST 3b 1985 COST	QUEST 3b 1986 COST	PERC. INCR. 85-'86
STATE TOTALS:	2,172,829	3,436,820	58%
SOCIAL SERVICE TOTALS:	105,808	234,968	- 122%
Social Service - 8	4,200	6,022	43%
Social Service - Shlter/halfway hm ml -8			
Social Service - fundraising -8			
Social Service -8	238	1,156	386%
Social Service -8	459	459	0%
Social Service -8			
Social Service -8	500	900	80%
Social Service -8	750	1,210	61%
Social Service -8			
Social Service -8	4,513	6,400	42%
Social Service -8			
Social Service -8	75	669	792%
Social Service -Counseling -8			
Social Service -Counseling 3,8			
Social Service League-8	1,323	1,918	45%
Social Service for immigrants-3,7,8		4,000	
Social Service, job training -7	6,000	10,000	67%
Social Service- 3,8	2,695	3,542	31%
Social Service- multi3,8	2,199	3,050	39%
Social Service-Counseling	3,293	5,000	52%
Social Service-Housing -8	13,963	17,142	23%
Social Service-fundraising -8	55,000	143,000	160%
Social Service/Daycare-1,7,8	2,600	6,500	150%
Social Service/multi- 3,7,8	8,000	24,000	200%
Social service, multipurpose -1,3,4,8			

	1984 COST	1985 COST	PERC. INCR. 84-'85
STATE TOTALS:	1,407,100	2,344,075	67%
SOCIAL SERVICE TOTALS:	79,564	97,059	22%
Social Service - 8	2,124	4,200	98%
Social Service -8	430	500	16%
Social Service -8	730	750	3%
Social Service -8	540	459	-15%
Social Service, job training -7	6,000	6,000	0%
Social Service- 3,8	2,604	2,695	3%
Social Service- multi3,8	1,100	2,199	100%
Social Service-Counseling	1,766	3,293	86%
Social Service-Housing -8	3,770	13,963	270%
Social Service-fundraising -8	54,500	55,000	1%
Social Service/multi- 3,7,8	6,000	8,000	33%

ORGANIZATION TYPE 1,2,3,4,5,6,7,8	QUEST 3b 1985 COST	QUEST 3b 1986 COST	PERC. INCR. 85-'86
STATE TOTALS:	2,172,829	3,436,820	58%
WOMEN/MEN AGENCIES/SERVICE TOTALS:	84,706	317,770	275%
Women's Rape Crisis-8	635	865	36%
Womens Org.-1,3,4,8			
Womens Shelter -8	148	4,812	3151%
YMCA -1,2,3,4,7,8	35,000	233,000	566%
YWCA - 2,3,4,8	5,883	9,093	55%
YWCA--1,2,3,4,8			
YWCA-1,2,3,4,7,8	43,040	70,000	63%

	1984 COST	1985 COST	PERC. INCR. 84-'85
STATE TOTALS:	1,407,100	2,344,075	67%
WOMEN AGENCY/SERVICE TOTALS:	40,506	72,398	79%
Women's Rape Crisis-8	485	635	31%
Womens Org.-1,3,4,8	24,621	28,575	16%
Womens Shelter -8	111	148	33%
YWCA-1,2,3,4,7,8	15,289	43,040	182%

APPENDIX B

REGIONAL SURVEY RESULTS

(1984 - 1986 COSTS)

ORGANIZATION TYPE 1,2,3,4,5,6,7,8	QUEST 3b 1985 COST	QUEST 3b 1986 COST	PERC. INCR. 85-'86
STATE TOTALS:	2,172,829	3,436,820	58%
AKRON TOTALS:	43,903	66,414	51%
Child/Youth Agency -3,4,8			
Community House- 2,8	1,225	2,400	96%
Community- multipurpose1,2,4,5,8	2,800	2,800	0%
Daycare -1	307	928	202%
Disabled residential Services-8	5,600	10,800	93%
Disabled, devl services -8	6,000	6,500	8%
Food Center -8	1,821	3,743	106%
Mental Health Counseling-8			
School District -6	5,200	6,400	23%
School District -6	1,132	2,195	94%
School District -6	5,105	7,387	45%
School District -6	7,618	9,674	27%
School District -6	1,124	1,544	37%
School District -6	4,500	5,313	18%
School, Private 1,6			
Social Service - fundraising -8			
Social Service League-8	1,323	1,918	45%
Womens Shelter -8	148	4,812	3151%
YWCA -1,2,3,4,8			

	1984 COST	1985 COST	PERC. INCR. 84-'85
STATE TOTALS:	1,407,100	2,344,075	67%
AKRON TOTALS:	41,540	75,496	82%
Child/Youth Agency -3,4,8	5,348	22,168	315%
Community- multipurpose1,2,4,5,8	2,450	2,800	14%
Daycare -1	307	307	0%
Disabled residential Services-8	4,900	5,600	14%
Disabled, devl services -8	5,500	6,000	9%
Food Center -8	1,811	1,821	1%
Mental Health Counseling-8	10,643	16,928	59%
School District -6	3,338	7,618	128%
School District -6	640	1,124	76%
School District -6	3,713	5,105	37%
School District -6	1,800	4,500	150%
School District -6	734	1,132	54%
School, Private 1,6	245	245	0%
Womens Shelter -8	111	148	33%

ORGANIZATION TYPE 1,2,3,4,5,6,7,8	QUEST 3b 1985 COST	QUEST 3b 1986 COST	PERC. IN R. 85-'86
STATE TOTALS:	2,172,829	3,436,820	58%
CANTON TOTALS:	139,942	173,769	24%
Child/juvenile deten/rehab-8			
Daycare -1	1,500	1,500	0%
Family Counseling/Services			
Health Services Agency -8	150	410	173%
Mental Health Agency -1,3	4,584	5,961	30%
Mental Health Services -8	2,756	3,680	34%
School District 6	1,580	2,310	46%
School District -6	1,964	3,406	73%
School District -6	13,860	22,116	60%
School District -6			
School, College -8	90,000	100,000	11%
Senior Center plus 1,2,4,5,7	20,255	29,386	45%
Social Service-Counseling	3,293	5,000	52%

	1984 COST	1985 COST	PERC. INCR. 84-'85
STATE TOTALS:	1,407,100	2,344,075	67%
CANTON TOTALS:	85,294	156,341	83%
Daycare -1	500	1,500	200%
Family Counseling/Services	888	553	-38%
Health Services Agency -8	150	150	0%
Mental Health Agency -1,3	4,114	4,584	11%
Mental Health Services -8	3,500	2,756	-21%
School District 6	1,062	1,580	49%
School District -6	1,147	1,964	71%
School District -6	4,737	15,846	235%
School District -6	10,278	13,860	35%
School, College -8	45,000	90,000	100%
Senior Center plus 1,2,4,5,7	12,152	20,255	67%
Social Service-Counseling	1,766	3,293	86%

ORGANIZATION TYPE I,2,3,4,5,6,7,8	QUEST 3b 1985 COST	QUEST 3b 1986 COST	PERC. INCR. 85-'86
STATE TOTALS;	2,172,829	3,436,820	58%
CINCINNATI	634,803	1,211,305	91%
Alcoholism Treatment center -8	1,500	3,000	100%
Child Counseling -3			
Child abuse prevention -8			
Child counseling, recreation headst. 3,4	620	620	0%
Child, adoption, counseling -8			
Child, legal service -8	1,200	1,200	0%
Community Center -multipurp. 1,2,3,4,8	5,400	8,904	65%
Community Center, daycare, rec-1,2,4	16,867	26,369	56%
Community Center-2,3,5			
Community Org -8	500	1,750	250%
Community multi-purpose -8			
Community, multipurpose -1,2,3			
Community, multipurpose -3,5,6	1,519	2,219	46%
Day care, referrals -1	334	490	47%
Daycare -1	809	809	0%
Daycare -1	95	95	0%
Disabled Center -4,8	4,211	5,339	27%
Disabled Group Homes -3,7,8	990	3,179	221%
Disabled Group Homes -8		3,400	
Disabled Services -7,8	5,000	6,000	20%
Disabled Services -7,8	17,907	15,143	-15%
Disabled Social Service -8			
Disabled Social Service -8	17,581	21,984	25%
Disabled housing/services -8		500	
Disabled services (ment. retarded) -8	2,000	15,000	650%
Disabled social services -8			
Disabled/Senior Transp Service -8	10,700	12,800	20%
Education progs- 8	38	38	0%
Education-8	720	2,000	178%
Food Pantry -8			
Food, clothing dist- 8			
Foodbank -8	15,000	20,000	33%
Health Dept. -8	5,400	6,100	13%
Health Dept. -8			
Health SErvices Agency -8			
Health Services Agency -8	83	83	0%
Health Services Agency -8			
Housing Authority -8	197,308	470,588	139%
Mental Health Board -8	2,270	4,500	98%
Mental Health Center -8			
Mental Health Center/Housing -8	24,000	40,000	67%
Mental Health center -8	8,500	17,000	100%
Mental Health, group homes -8			
School Distrct -8			
School District -6	4,895	8,214	68%
School District -6	142,378	197,548	39%
School District -6	9,123	13,152	44%
School District -6	300	1,040	247%

ORGANIZATION TYPE I,2,3,4,5,6,7,8	QUEST 3b 1985 COST	QUEST 3b 1986 COST	PERC. INCR. 85-'86
STATE TOTALS;	2,172,829	3,436,820	58%
CINCINNATI	634,803	1,211,305	91%
School District -6	7,300	7,800	7%
School District -6	4,000	8,000	100%
School District -8	13,481	37,202	176%
School District- 6	15,630	30,149	93%
Senior Social Service-2,4,8	3,394	4,870	43%
Senior/Social Service	169	169	0%
Social Service - 8	4,200	6,022	43%
Social Service - Shlter/halfway hm ml -8			
Social Service -8	750	1,210	61%
Social Service -8	4,513	6,400	42%
Social Service -8	75	669	792%
Social Service -8	459	459	0%
Social Service -8	500	900	80%
Social Service -8	238	1,156	386%
Social Service -8			
Social Service -8			
Social Service -Counseling -8			
Social Service for immigrants-3,7,8		4,000	
Social Service-Housing -8	13,963	17,142	23%
Social Service-fundraising -8	55,000	143,000	160%
Social Service/multi- 3,7,8	8,000	24,000	200%
Social service, multipurpose -1,3,4,8			
YWCA - 2,3,4,8	5,883	9,093	55%

ORGANIZATION TYPE 1,2,3,4,5,6,7,8	QUEST 3b 1984 COST	QUEST 3b 1985 COST	PERC. INCR. 84-'85
STATE TOTALS:	1,407,100	2,344,075	67%
CINCINNATI TOTALS:	318,844	614,757	93%
Child Counseling -3	2,900	5,000	72%
Child, legal service -8	1,100	1,200	9%
Community Center -multipurp. 1,2,3,4,8	3,360	5,400	61%
Community Center-2,3,5	250	550	120%
Community, multipurpose -3,5,6	840	1,519	81%
Day care, referrals -1	203	334	65%
Daycare -1	95	95	0%
Daycare -1	200	809	305%
Disabled Center -4,8	2,398	4,211	76%
Disabled Group Homes -3,7,8	698	990	42%
Disabled Services -7,8	11,464	17,907	56%
Disabled Social Service -8	17,774	17,581	-1%
Disabled services (ment. retarded) -8	2,000	2,000	0%
Disabled/Senior Transp Service -8	5,000	10,700	114%
Education progs- 8	38	38	0%
Foodbank -8	12,000	15,000	25%
Health Dept. -8	2,450	5,400	120%
Health SErvices Agency -8	892		-100%
Health Services Agency -8	83	83	0%
Housing Authority -8	25,438	197,308	676%
Mental Health Center -8	2,200	6,673	203%
Mental Health Center/Housing -8	12,000	24,000	100%
Mental Health center -8	5,000	8,500	70%
Mental Health, group homes -8	4,500	5,917	31%
School District -6	4,625	4,895	6%
School District -6	99,413	142,378	43%
School District -6	6,635	9,123	37%
School District -6	3,800	7,300	92%
School District -6	3,000	4,000	33%
School District -6	300	300	0%
School District -8	10,496	13,481	28%
School District- 6	6,117	15,630	156%
Senior Social Service-2,4,8	3,312	3,394	2%
Senior/Social Service	169	169	0%
Social Service - 8	2,124	4,200	98%
Social Service -8	540	459	-15%
Social Service -8	430	500	16%
Social Service -8	730	750	3%
Social Service-Housing -8	3,770	13,963	270%
Social Service-fundraising -8	54,500	55,000	1%
Social Service/multi- 3,7,8	6,000	8,000	33%

ORGANIZATION TYPE 1,2,3,4,5,6,7,8	QUEST 30 1985 COST	QUEST 38 1986 COST	PERC. INCR. 85-'86
STATE TOTALS;	2,172,829	3,436,820	58%
CLEVELAND TOTALS:	914,928	1,302,137	42%
Alcohol Outpatient Treatment 8			
Child and Family Counseling -3,8	1,100	2,283	108%
Child/youth resid treatment-1,3,8			
Community Econ. Devlp-5	998	1,768	77%
Community-multi purpose-1,2,3,4,5,7,8	750	4,000	433%
Community-multiporpose-1,2,3,4,5	4,000	3,600	-10%
Daycare -1			
Daycare -1			
Disabled Residential services -8	7,228	29,408	307%
Disabled, social service -8	20,600	28,075	36%
Health Services Agency -3	900	1,400	56%
Mental Health residen/job training -8	3,681	11,498	212%
School District 6			
School District -1,4,6	8,000	9,500	19%
School District -6	5,591	7,680	37%
School District -6	2,100	2,500	19%
School District -6			
School District -6	3,105	3,582	15%
School District -6	12,325	17,718	44%
School District -6	13,095	9,849	-25%
School District -6	1,100	4,580	316%
School District -6	9,180	10,800	18%
School District -6	730,000	835,000	14%
School district -6	12,500	15,031	20%
Senior Centers -8			
Women's Rape Crisis-8	635	865	36%
WMCA-1,2,3,7,8	35,000	233,000	556%
YWCA-1,2,3,4,7,8	43,040	70,000	63%

	1984 COST	1985 COST	PERC. INCR. 84-'85
STATE TOTALS:	1,407,100	2,344,075	67%
CLEVELAND TOTALS:	511,094	828,111	62%
Child and Family Counseling -3,8	457	1,100	141%
Child/youth resid treatment-1,3,8	3,535	6,855	94%
Community Econ. Devlp-5	710	998	41%
Community-multi purpose-1,2,3,4,5,7,8	725	750	3%
Community-multiporpose-1,2,3,4,5	700	4,000	471%
Health Services Agency -3	800	900	13%
Mental Health reside/treatment/job train-7,8	3,589	3,681	3%
School District 6	2,010	2,772	38%
School District -1,4,6	6,000	8,000	33%
School District -6	3,121	3,105	-1%
School District -6	5,563	9,180	65%
School District -6	4,118	13,095	218%
School District -6	463,992	730,000	57%
Women's Rape Crisis-8	485	635	31%
YWCA-1,2,3,4,7,8	15,289	43,040	182%

ORGANIZATION TYPE 1,2,3,4,5,6,7,8	QUEST 3b 1985 COST	QUEST 3b 1986 COST	PERC. INCR. 85-'86
STATE TOTALS:	2,172,829	3,436,820	58%
DAYTON TOTALS:	125,699	220,196	75%
CAP Agency -1,3,8	4,015	9,545	138%
Child Counseling -3	3,447	5,365	56%
Child/resident care/gp homes -8	6,866	10,878	58%
Community Center -2,5,8			
Day Care Center 1	2,266	2,993	32%
Daycare - 1	900	1,200	33%
Daycare -1			
Disabled Services -3,8	11,137	12,200	10%
Family Services -8	7,979	15,351	92%
Health Care Agency -8	2,687	4,901	82%
Health care service agency-8	700	1,100	57%
Recreational Activity -4			
Recreational Activity -4			
School District -6	12,911	12,911	0%
School District -6	2,734	3,152	15%
School District -6	9,457	15,000	59%
School District -6	60,000	125,000	108%
Senior Center-4,8	600	600	0%
Womens Org.-1,3,4,8			

	1984 COST	1985 COST	FERC. INCR. 84-'85
STATE TOTALS:	1,407,100	2,344,075	67%
DAYTON TOTALS:	87,378	159,973	83%
CAP Agency -1,3,8	3,021	4,015	33%
Child Counseling -3	2,223	3,447	55%
Child/resident care/gp homes -8	4,501	6,866	53%
Day Care Center 1	1,440	2,266	57%
Daycare - 1	800	900	13%
Disabled Services -3,8	3,714	11,137	200%
Family Services -8	4,497	7,979	77%
Health Care Agency -8	2,687	2,687	0%
Recreational Activity -4	2,500	3,000	20%
Recreational Activity -4	3,700	3,999	8%
School District -6	1,000	2,734	173%
School District -6	5,573	12,911	132%
School District -6	21,000	60,000	186%
School District -6	6,101	9,457	55%
Womens Org.-1,3,4,8	24,621	28,575	16%

ORGANIZATION TYPE 1,2,3,4,5,6,7,8	QUEST 3b 1985 COST	QUEST 3b 1986 COST	PERC. INCR. 85-'86
STATEWIDE TOTALS:	2,172,829	3,436,820	58%
COLUMBUS TOTALS:	108,150	164,242	52%
Daycare -1	7,516	11,196	49%
Daycare -1	1,100	1,100	0%
School District -6	2,188	4,626	111%
Child, Social service -8	850	6,700	688%
Daycare -1			
Daycare -1			
Daycare -1	235	1,000	326%
Daycare -1			
Daycare -1	1,200	2,870	139%
Daycare -1			
Daycare -1			
Daycare -1	1,300	1,300	0%
Daycare-1	1,600	1,800	13%
Daycare-1	600	850	42%
Daycare-1			
Daycare/camp -1,8			
School Distrct -6			
School District -6	7,661	13,000	70%
School District -6			
School District -6			
School District -6	7,000	10,000	43%
School District -6	4,100	4,800	17%
School District -6	16,000	28,000	75%
School District 1,6	38,000	50,000	32%
School District _6			
School District- 6			
School District-6			
School, private -1,6	2,800	3,000	7%
School, private -6			
School, private -6	16,000	24,000	50%
Senior Daycare -1			

	1984 COST	1985 COST	PERC. INCR. 84-'85
STATE TOTALS:	1,407,100	2,344,075	67%
COLUMBUS TOTALS:	180,733	233,976	29%
Daycare -1	5,676	7,516	32%
Daycare -1	5,676	7,516	32%
School District -6	1,557	2,188	41%
Child, Social service -8	525	850	62%
Daycare -1	235	235	0%
School District -6	1,240	1,806	46%
School District -6	14,000	16,000	14%
School District -6	4,000	7,000	75%
School District -6	3,000	4,100	37%
School District- 6	16,000	24,000	50%
School District-6	125,500	144,281	15%
School, private -6	9,000	26,000	189%

ORGANIZATION TYPE I,2,3,4,5,6,7,8	QUEST 3b 1984 COST	QUEST 3b 1985 COST	PERC. INCR. 84-'85
STATE TOTALS:	1,407,100	2,344,075	67%
TOLEDO TOTALS:	143,343	215,215	50%
Alcoholic residential treatment -8	2,265	4,200	85%
Alcoholic/drug treatment -3,4,8	270	270	0%
CAP Agency -1,3,5,6,8	20,869	39,129	87%
Child Counseling, other -3,8	1,869	1,869	0%
Child Counseling, shelter -3,8	2,746	2,387	-13%
Child Counseling-3	1,947	2,460	26%
Child/Youth Club-2,3,4,8	17,000	28,000	65%
Child/Youth residential treatment -8	9,101	11,127	22%
Community Center -2,4,8	329	500	52%
Community Econ. Devlp-5,8	3,000	3,000	0%
Disabled Reside/treatment -3,8	3,325	5,027	51%
Disabled Social SErvice - 8	1,428	2,695	89%
Disabled, voc rehabiliation 7,8	16,597	30,281	82%
Educational org for girls -8	1,332	2,107	58%
Family Services -8	2,578	5,000	94%
Family planning -8	11,244	11,729	4%
Mental Health -outpatent & resident-8	6,463	7,991	24%
School District -6	2,608	5,362	106%
School District -6	2,189	5,659	159%
School District -6	10,522	18,086	72%
School District -6	3,957	5,442	38%
School District -6	12,000	12,000	0%
Social Service, job training -7	6,000	6,000	0%
Social Service- 3,8	2,604	2,695	3%
Social Service- multi3,8	1,100	2,199	100%

ORGANIZATION TYPE I,2,3,4,5,6,7,8	QUEST 3b 1985 COST	QUEST 3b 1986 COST	PERC. INCR. 85-'86
STATE TOTALS:	2,172,829	3,436,820	58%
TOLEDO TOTALS:	163,226	242,269	48%
Alcoholic residential treatment -8	4,200	5,598	33%
Alcoholic/drug treatment -3,4,8	270	5,000	1752%
CAP Agency -1,3,5,6,8			
Child Counseling, Foster care-3,8			
Child Counseling, other -3,8	1,869	3,985	113%
Child Counseling, shelter -3,8	2,387	2,500	5%
Child Counseling-3	2,460	4,677	90%
Child abuse counseling-8	674	2,383	254%
Child/Youth Club-2,3,4,8	28,000	35,000	25%
Child/Youth residential treatment -8			
Community Center -2,4,8			
Community Econ. Devlp-5,8	3,000	3,000	0%
Community-multipurpose, 2,4,8			
Day care -1	1,500	3,470	131%
Daycare/nursery scho-1			
Disabled Reside/treatment -3,8	5,027	1,729	-66%
Disabled Social SErvice - 8	2,695	4,250	58%
Disabled, voc rehabiliation 7,8	30,281	38,129	26%
Educational org for girls -8	2,107	9,500	351%
Family Services -8	5,000	10,087	102%
Family planning -8	11,729	20,425	74%
Mental Health -outpatent & resident-8	7,991	12,777	60%
Recreational, youth counseling-3,4			
School District -6	1,889	2,724	44%
School District -6	5,442	6,406	18%
School District -6	5,362	7,725	44%
School District -6	12,000	22,000	83%
School District -6	18,086	22,612	25%
School District -6			
Senior Center -2,4,8	363	1,700	368%
Social Service -8			
Social Service -Counseling 3,8			
Social Service, job training -7	6,000	10,000	67%
Social Service- 3,8	2,695	3,542	31%
Social Service- multi3,8	2,199	3,050	39%

ORGANIZATION TYPE 1,2,3,4,5,6,7,8	QUEST 3b 1985 COST	QUEST 3b 1986 COST	PERC. INCR. 85-'86
STATEWIDE TOTALS:	2,172,829	3,436,820	58%
SOUTHEAST OHIO TOTALS:	42,178	56,488	34%
CAP agency-1,2,3,4,5,6,7,8			
CAP agency-1,5,7,8			
CAP-5,8	20,517	23,000	12%
Community - multipurpose; 3,5,7			
Community, Reg. Devl Dist. -5,8	650	1,800	177%
Daycare -1	800	800	0%
Daycare -1			
Housing Authority -8	6,832	9,946	46%
Mental Health Board	1,491	2,941	97%
School District -6	7,088	8,151	15%
School District -6	2,200	3,350	52%
Social Service/Daycare-1,7,8	2,600	6,500	150%

	1984 COST	1985 COST	PERC. INCR. 84-'85
STATE TOTALS:	1,407,100	2,344,075	67%
SOUTHEAST OHIO TOTALS:	38,874	57,702	48%
CAP agency-1,2,3,4,5,6,7,8	18,888	31,509	67%
CAP agency-1,5,7,8	1,000	1,000	0%
Community - multipurpose; 3,5,7	2,865	4,450	55%
Community, Reg. Devl Dist. -5,8	650	650	0%
Daycare -1	800	800	0%
Daycare -1	737	1,682	128%
Housing Authority -8	4,996	6,832	-2%
Mental Health Board	683	1,491	118%
School District -6	5,155	7,088	37%
School District -6	1,100	2,200	100%

Senator METZENBAUM. Our next witness is Lila Coughran, executive director, Texas Easter Seal Society, of Austin, TX. We are happy to have you here.

Ms. COUGHRAN. Thank you, sir. I am very pleased to have the opportunity to speak to you on my organization's insurance dilemma.

I'd like to request that my full statement be submitted for the record.

Senator METZENBAUM. All of the full statements will be included in the record.

Ms. COUGHRAN. Thank you.

My name is Lila Coughran, and I am the executive director of the Texas Easter Seal Society.

Our problems first started in the summer of 1985. I received a call from our insurance agent, who informed me that our van insurance was being called with 2 hours' notice. I called him back and I said, "Bill, what's happening?"

He said, "It's because you are transporting handicapped children on buses."

I said, "You know we have been doing that for years. You visit our center every year, and you know we have been doing it."

He said, "We are not going to carry your insurance anymore."

We went scrambling and got van insurance through an assigned risk pool, and it was much more expensive. We also begin to realize we were going to have significant problems getting other insurance coverage.

All of our insurance policies expired in January 1986 or early February. By the third week in January, we still could not get quotes on our insurance package.

Our account executive spoke to the board and told the board that we were not going to be able to obtain some forms of insurance, particularly professional liability insurance, the reason being that what we do is supposedly high-risk. We have been doing the same work for over 40 years, and we have never had a claim of any kind.

In order to be affiliated with the Easter Seal Society, you must be accredited by the Commission on Accreditation of Rehabilitation Facilities, CARF. They mandate very strict compliance with risk management and safety. We are very careful. We have never been sued. We have never had a claim. And we have never been to court about anything in spite of the fact that our activities are high-risk.

We transport infants who have seizures on buses to our center. They could not get treatment otherwise. We take disabled children to camp and swimming and canoeing. We perform therapies with children and provide special education classes.

We were not able to get insurance by the time the insurance policies expired. Our professional liability ran out January 26, 1986. I will never forget it because it was the day that the Challenger crashed. The board voted that we would not stay open if we could not get our insurance placed.

Please understand that many of our board members are parents of children with disabilities, and they were unwilling to risk their own personal assets in case of a lawsuit. So we were forced to close the center for a day.

Our liability insurance was turned down by 35 companies before we finally received coverage. You feel like you are selling your soul to get your insurance and like you are being punished for something you have never done.

We had to switch from an admitted carrier to a surplus line, and that first year our premiums increased over 1,000 percent for professional liability—from $1,600 to $17,000. We are now paying $23,000 a year just for professional liability.

Another problem is that our carriers require all of our professional staff to carry their own professional liability, and they have to provide a check stub and proof that they have purchased it. That exacerbates our personnel problems because it is hard to find good professional staff to work with these children.

With the increase in premiums, we've gotten less for our money. Many of our policies now contain exclusions—for example, physical abuse in our day care programs is excluded, as is sexual abuse. What used to be covered under our general liability—for example, special events, spectator and participant insurance—is no longer covered, and we have to pay additional premiums. We also have to pay an additional premium for each camp that we operate, and that used to be covered under our general liability.

We were told we didn't have liquor liability, and that meant we couldn't do fundraising events in which liquor was involved—for example, galas or softball marathons or other sporting events.

We have been trying to get participant insurance for our special events and fundraisers for 5K runs, volleyball marathons. The only participant coverage that we could get was $1,500 for one event, and that was for a total coverage of $12,500.

Our insurance package is 10 percent of our entire budget, and that is ridiculous. We would rather provide special education programs and treatment for children like this, instead of for insurance premiums.

Thank you very much.

Senator **Metzenbaum**. Thank you very much for your very telling and striking testimony. I agree with you—we'd rather you provide protection for that little girl than pay it to the insurance carriers.

[Statement of Ms. Coughran follows:]

LILA COUGHRAN

EXECUTIVE DIRECTOR, TEXAS EASTER SEAL SOCIETY

TESTIFYING BEFORE THE SENATE JUDICIARY COMMITTEE

SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS

HEARING ON THE McCARRAN-FERGUSON ACT/STATE ANTITRUST ACTION AGAINST INSURANCE COMPANIES

WASHINGTON, D.C.

June 14, 1988

Mr. Chairman, I am pleased to have the opportunity to speak to you on my organization's insurance dilemma.

I would like to request that my full statement be submitted for the record.

I am Lila Coughran, Executive Director of the Texas Easter Seal Society.

Our problems first started in the summer of 1985. We received a call from our insurance agent telling us that our van insurance was being cancelled with two hours notice. When I asked why, he said, "It's because you're transporting handicapped children in buses." I said, "You know we've been doing that for years." He just said, "We're not going to carry your insurance anymore."

In fact, the same agent had recently come to our rehabilitation center and made a talk to the staff on all the horrendous lawsuits being filed and problems insurance companies were having because of it. He really scared the staff. He told them that the center's insurance would not cover them as individuals and that they should carry their own policies.

We had to get van insurance in an assigned risk pool which was more expensive. And we began to realize we were going to end up having problems in other areas of insurance as well.

All of our insurance policies expired the end of January or early February. By the third week of January, we still did not have quotes.

Our account executive informed the Board that we were not going to be able to obtain many policies, particularly professional liability insurance. The reason being that what we do is supposedly high risk. We've been doing the same work for years and years -- 40 years all together -- and never had a claim of any kind.

In order to be affiliated with the Easter Seal Society, we must be accredited by the Commission on Accreditation of Rehabilitation Facilities. CARF mandates extremely stringent levels of risk management and safety. We exercise great safety precautions.

We've never been sued. We've never had a claim. And we've never been to court about anything -- in spite of the fact that our activities are high risk.

For example, we transport infants who have seizures on a bus to the center. They could not get treatment otherwise. We have a recreation program, and we take disabled children canoeing. We have classrooms for children with disabilities, and we perform physical therapy on children.

We were not able to get insurance by the time our policies expired. Our professional liability ran out January 28, 1986. I will never forget it because it was the day the Challenger crashed.

The Board voted that we would not stay open if we could not get our insurance placed. We were forced to close the center for a day.

Our liability insurance was turned down by 35 companies before we finally received coverage. You feel like you're selling your soul, like you're being punished for something you didn't do. It's shameful.

We had to switch from an admitted carrier to a surplus line. That first year, our premiums increased over 1,000% for professional liability -- from $1,600 to $17,000. We were forced to switch from an occurrence policy to a claims-made. Another problem that we've had is that carriers require our professional staff -- physical therapists, occupational therapists, speech therapists, and social workers -- to carry their own liability insurance. They have to provide proof of it.

We cannot afford to pay for the staff's individual coverage in addition to the cost of our general insurance package. For example, our physical therapists' personal liability insurance is $300 a year. It's very difficult to find and keep professional staff with this added burden. It exacerbates our personnel problems.

With the increase in premiums, we have gotten less for our money. Many of the policies contain exclusions, such as sexual and physical abuse in our day-care programs, that we did not previously have. Not only that, what used to be covered under our general liability -- special events, spectator and participant insurance -- we now have to pay separate premiums for.

We were told we did not have liquor liability and could not get it. That meant we could do no fundraising where liquor was involved, like a gala or a softball marathon where beer was given as a price to the players.

We've been scrounging around trying to get participant insurance for our special events and fundraisers. For example, we have a lot of sports events like 5K runs and softball and volleyball marathons. The only participant insurance we found cost us $1,500 per event for $12,500 total coverage, not for one participant, but total coverage for the entire event.

We run camps all over the state of Texas. We have had to pay a separate premium for each camp whereas that was covered in our general liability before.

We have had to work much harder at raising money at a time when it is already difficult because of the economy. We can't pass the cost of our insurance on to our clients because most of them don't pay for services.

Our total insurance cost is approximately 10% of our entire budget and that's just ridiculous. That money could be spent on direct services for persons with disabilities.

It has been very difficult to budget for our insurance. The companies won't give binders until the day it expires. I spend an inordinate amount of time getting quotes and sweating out binders.

We sent out bids last August to solicit insurance packages to six companies and only two responded. Our present agent said they would renew, but they really did not want to deal with us because they weren't making enough money off us. That was a direct quote, "We're not making enough off you."

It's frustrating. It's very frustrating.

In 1985, our total insurance package was $13,000. Next year, it will be $117,000. That is almost a 1,000% increase in a three-year period. As I mentioned earlier, approximately 10% of our entire budget goes for insurance coverage. That additional money spent on insurance could provide services for 100 people.

Rehabilitation is very cost effective in spite of the insurance, in terms of preventing long-term disability. An example is the Capital Area Easter Seal Rehabilitation Center poster child. The therapy she receives will save the state at least $100,000 by the time she graduates from high school. She's going to walk into public school instead of roll. A year and a half ago, she could only move by rolling like a seal.

Money needs to be spent in therapy, not on insurance!

Senator **Metzenbaum**. We will hear next from Louis Grumet, executive director, New York State School Boards Association.

Mr. **Grumet**. Mr. Chairman, I have submitted the testimony; I am not going to repeat it here. I would like to highlight some answers to some of the questions that came up this morning, if I may.

We are an association, just in short, that represents 750 school districts, ranging from the city of New York, the largest district in the country, to a lot of little districts. We provide programs for children with handicapping conditions. And we have all of these problems, and I will not detail them for you.

What I would like to detail is this morning I had a feeling when the insurance representatives were speaking and Senator Hatch was speaking that I was attending Alice in Wonderland's tea party. There may be 3,500 insurance companies out there competing with each other, but not in the State of New York, not providing liability insurance to school districts who serve 3 million children, Senator.

We have during the insurance crisis approximately three or four insurance companies, and they divided the State geographically. Over 80 percent of the districts could not get more than one bid if they could get any bids at all.

I think it is absolute distortion to say there is competition in the insurance industry. I think all that we heard this morning about the States doing things—we saw this morning that Attorney General Abrams has been a leader in this field; our own insurance commissioner has been a leader in this field—but the culprits are not within the State of New York, Mr. Chairman. They are in London.

There is an international conspiracy, and our association, in an attempt under the authority of our State legislature to set up our own business to go into insurance ourselves so that we could deal with the crisis and serve our own members, and we submit we were driven out of business by a conspiracy, sir. And we indeed are filing a claim in front of our own superintendent of insurance under New York State laws, and we will be pursuing that claim to receive and recover $450,000 which we spent.

We believe indeed the insurance industry and particularly the reinsurers made very, very sure that we could not get into business to serve our members. When you talk about data—and Senator Simon asked a number of questions about data—the insurance industry talked a great deal this morning about the data that is there and how certainly the superintendent of insurance from Wyoming would be able to get the data. The fact is that the insurance industry in the great State of New York would not give the New York State Legislature in public hearings the data that you are discussing. And they were requested in formal public hearings by the insurance committees of the New York State legislature to give the type of data that you are talking about.

We submit that it was a manufactured crisis we are talking about. We submit that when they talked about school districts, villages, towns, cities and counties, they did not have the data upon which to set the rates. But indeed, we were told by the largest insurance broker in the world that Lloyd's of London also decided to not serve municipal governments in the United States because, quote, "They had a high risk." And some of my colleagues who are here, testifying to the fact that they could not get insurance, they had lower coverage and higher rates, because of a decision that was made in England, a decision that was not made upon fact, a decision that was not made upon coverage.

We would urge you, sir, not only to repeal the Act that you are talking about and to pass your amendment, but also to require that the information which is now collected by ISO be required by a branch of the U.S. Government and be made public so that the municipal governments and the not-for-profit agencies of this country can make their own decisions on insurance. We do not believe the insurance industry. We think they are lying to us, sir.

Senator METZENBAUM. Thank you very much, Mr. Grumet.

[Statement of Mr. Grumet follows:]

Testimony on

THE LIABILITY INSURANCE CRISIS TWO YEARS LATER: COMPETITION IS THE SOLUTION

before the
Senate Judiciary Subcommittee on Antitrust
Monopolies & Business Rights

by
Louis Grumet, Esq.
Executive Director
New York State School Boards Association
New York State School Services Foundation

to be held in the
226 Dirksen Office Building
Washington, DC

June 14, 1988

My name is Louis Grumet.

I am the Executive Director of the New York State School Boards Association, an organization which represents 98% percent of the elected school boards of the State of New York. The 5,000 members of our organization are responsible for the education of 3 million children in school districts ranging from the City of New York, the largest school district in the nation, to rural school districts which serve under 1,000 children. The school boards in New York State spend approximately $18 billion dollars annually to educate their children and we are finding that an ever increasing percentage of this total must be spent to provide adequate insurance coverage for local districts. Approximately two years ago, school boards of New York State, like all school boards across the nation, discovered that insurance was not just one line item in the budget. As a result of a manufactured crisis, they discovered that they could no longer provide certain types of educational programming because people in London were determining what children in New York State were going to learn.

Excellent programs in every area of the curriculum from athletics to science, from early childhood education to dropout prevention were threatened or forced to be cut by school districts because faceless individuals in the insurance industry determined them to be too risky to be insured or charged too much to insure them. Furthermore, while the President, the Congress and the Nation were calling for reform in education to improve excellence in the wake of the "Nation at Risk" report, many of the dollars that were being appropriated by the New York State Legislature and by the school boards of New York were being channelled not to improve teacher salaries, not to improve educational programs, not to use new learning technologies but to increase the insurance budget.

During the crisis, in New York State, school districts liability insurance costs rose up to four hundred (400) percent, while coverage was cut in half based upon the assertion by the insurance industry that school districts were a "high risk." Based upon our experience, we submit to you, there is no data to substantiate the claim that school districts are a "high risk" and that there is no genuine actuarial basis for rate setting of school districts by the industry. It is interesting to note that there are no special categories for school districts or municipalities in the Insurance Services Office (ISO) classifications system and yet, all public statements of the industry seem to indicate that there are tremendous risks in insuring school districts.

The industry continues to give a handful of examples of multi-million dollar claims for bizarre incidents, but we submit to you, there are no more than a handful of such examples. Our position is based upon our very careful analysis of the industry which we undertook since the insurance crisis began.

Our Association has asked the New York State Legislature to enact legislation this year which would require any insurance company dealing with local or state government to report quarterly to those entities so that they would not be taken unaware by any drastic unexpected increase in insurance premiums in the future and so that they can see whether any such increases were justified by experience. We continue to believe that too much money is being deflected from what is truly important to our education system, the education of students, based upon the unsubstantiated claims of the insurance industry that they require higher rates.

During the height of the insurance crisis, school districts such as the district of Altmar-Parish, a small rural school district were faced with a rise in insurance premiums from $4,500 dollars to $25,000 dollars per year. We should point out that this $25,000 figure represents the cost of a teacher's salary to a small school district.

School districts learned very quickly that this problem was not theirs alone. The towns, the villages, the counties and cities in New York State were all facing the same insurance crisis except for the City of New York itself which was large enough to be self-insured. As a result, a coalition of local governments, school districts, and the City of New York was formed to deal with the insurance crisis. We went to the New York State Legislature and the Governor and were able to secure special legislation which gave us the opportunity to establish a statewide municipal reciprocal insurance company. Under this legislation we were required to enlist at least 25 subscribing school districts as participants in the reciprocal. We established the New York State School Services Foundation, a not-for-profit corporation, and assembled an impressive array of experts to carry out the company's functions. We turned to Marsh and McLennan, the world's largest insurance broker and marketer. They put together for us a team which included General Reinsurance, American Reinsurance, two of the world's largest reinsurance corporations; the Hartford Steam Boiler Corporation, for boiler and machinery coverage; the Travelers Insurance Company for claims administration; and Forrest T. Jones, for errors and omissions coverage.

We entered the insurance business solely to provide ample coverage to school districts at reasonable prices and to educate school districts on how to reduce their exposure. We believed that Marsh and McLennan put together a first-rate team to meet the needs of school districts in a short-period of time. The reciprocal was to be very closely regulated by the Superintendent of Insurance and a great amount of risk management was required. At the direction of the Governor, the New York State

Superintendent of Insurance, provided us with a tremendous amount of technical assistance. We are grateful to the Governor and the State Legislature for their cooperation and strong support. To provide us with working capital, the Superintendent of Insurance helped us secure a $10 million dollar loan from the Metropolitan Life Insurance Company. We felt prepared to meet the crisis. Then some very strange things occurred. Things which we believed would not have occurred had the legislation, which is the subject of this hearing been enacted into law.

While we attempted to secure the requisite 25 subscribers, school districts across New York State began receiving quotes from their traditional carriers which were substantially below the rates which we were able to offer and which interestingly enough, were substantially below the rates which had been quoted to them prior to the formation of our reciprocal. In at least one instance, our competition offered a premium which was $150,000 thousand dollars less than the year before. While the premiums which were being offered to school districts by our competitors were being dramatically reduced, the rates we were quoted by our reinsurers were usually too high to permit us to be competitive. Not only were the rates too high but they were often too late for our districts to consider them. For example, we received inquiries for quotes from more than half our members, roughly 400 school districts, but were unable to offer a price proposal to more than 100 of these school districts despite my staff's repeated requests for pricing information to Marsh and McLennan. One by one, our districts signed up to buy insurance from our competitors. We believe that the industry worked against our interests and the interests of all school districts in New York State.

We have many unanswered questions which are the subject of a formal complaint which we will file with the Superintendent of Insurance of the State of New York. We will take this action to seek redress for a sum of approximately $450,000 dollars which our Association expended in attempting to set up our reciprocal not-for-profit corporation. We assert that our reciprocal was precluded from entering the insurance business by the industry. On behalf of our 750 school district members, we strongly support the work of the Attorneys General which is aimed at defending the consumers and taxpayers of this nation against a conspiracy which may have cost this nation billions of dollars in the same manner as in the OPEC oil embargo of 1974 and 1979.

One of the reasons that we believe that we were the victim of a conspiracy is that once our reciprocal became a viable competitor, the insurance rates of school districts in New York State dropped much faster than they did in other states and dropped much faster than town village and city rates in New York State. We allege that this dropping of rates was intended to drive us out of business. We suspect that this dropping or softening of insurance rates will continue for at least the length of time which the Attorneys General's litigation continues.

Just as the nation needed an energy policy to make sure that we could deal with a oil embargo, our nation now needs a policy to make sure that a small group of insurers are not allowed to compete with our nation's need for educational reform by unfairly dictating how much of our education dollar is needed to pay for insurance. The school districts of the State of New York strongly believe that an important cornerstone of that policy is the bill which you are now assembled to discuss and we urge you to make it law.

I thank you for the opportunity to testify before this Senate Judiciary Subcommittee on Antitrust, Monopolies and Business Rights. If you have any questions I would be happy to answer them at this time.

NEW YORK STATE
SCHOOL BOARDS ASSOCIATION
119 Washington Avenue, Albany, New York 12210 • (518) 465-3474

June 16, 1988

The Honorable Howard M. Metzenbaum, Chairman
Judiciary Subcommittee on Antitrust Monopolies and Business Rights
308 Senate Hart Office Building
Washington, DC 20510-6275

Dear Senator Metzenbaum:

It was a privilege to be afforded the opportunity to share the experiences of the school districts of New York State with you and the other members of the subcommittee on June 14. I would like to elaborate on some of the points made at that hearing.

Senator Hatch mentioned that the casualty and liability insurance industry consisted of approximately 3,500 companies, none of which control more than eight percent of the market share. While that might be true in terms of all companies, as Attorney General Abrams mentioned, there are "choke points" with in the industry. Thus, the inability to get reasonably-priced reinsurance for our program "choked off" any real chance we had of getting into business.

In addition, there are certainly far fewer than 3,500 companies competing in New York State for school district business. There are probably not more than 10 or 12 companies in New York willing to underwrite school districts. This represents at the least, an oligopoly, if not a monopoly.

I also must restate how difficult it is to collect meaningful loss and claim data from insurance companies. Even the New York State Legislature found it difficult to get data from the companies. For example, at a hearing before the New York State Assembly Insurance Committee, the late Jack Riffle, President of Utica Mutual, (a New York-based company), simply refused to state what effect certain tort reforms sought by the company would have on insurance rates. He would not even hazard a guess.

(more)

It is thus obvious that stronger oversight of the action of these companies, such as your bill would permit, is crucial. One has to wonder why the companies are so concerned about the repeal of McCarran-Ferguson. If, as they claim, the State Commissioner of Insurance already has the power to enforce state antitrust laws against the industry, then repealing McCarran-Ferguson would have no additional ill effect on the insurance industry.

We strongly support S 1299. Please contact my office if I can be of assistance.

Sincerely,

Louis Grumet
Executive Director

Senator **Metzenbaum**. Our last witness is Mr. Moody, town counsel, town of Milford, Milford, MA.

Mr. **Moody**. Thank you, Mr. Chairman.

As town counsel, of course, that means town attorney for the town. You have my prepared testimony, and I know the time is short, and I won't bother to read that if you could introduce that into the record.

Senator **Metzenbaum**. All of your statements will be included in the record in their entirety.

Mr. **Moody**. I'll just make a few brief statements to highlight a few items. As you probably know, Milford is a named party plaintiff in this lawsuit along with the town of Hanover, MA.

Milford was in part chosen because it is a good, classic example of the effects of this artificial insurance conspiracy—not dramatic effects—we didn't have to eliminate any positions, we didn't close any parks. The effects are strictly financial.

If you look at the testimony we have provided, it shows you that we had a 3-year policy in the 1984–1987 period with the Hartford Insurance Company, the first-year premium being $32,600. This was an occurrence-type policy.

Before the beginning of the third year of that policy, we were informed outright by Hartford that it was being cancelled and wasn't going to be available any longer. Our insurance broker was unable to place the insurance on an occurrence basis with any other company at any other price.

But finally, we were able to get a claims-made type of policy with a surplus lines company—not regulated, being a surplus lines company—for a premium of $124,000. That company was known as the Nutmeg Insurance Company which, as it turned out, is a wholly-owned subsidiary of the Hartford. That was for the 1986 to 1987 period, August 1986 to August of 1987. Plus our premiums increased something in terms of fourfold for coverage that probably wasn't worth one-tenth of the previous coverage.

We got through that policy period. The costs were tremendous. Other insurance costs on other policies we carried escalated. Our overall premiums for all of our insurances went from about $100,000 to about $600,000—a very devastating effect on a relatively small community. But we wanted the insurance, we needed the insurance, and we carried the insurance.

Lo and behold, after the 1987 period and the claims-made policy being in effect, suddenly the Hartford is willing to offer an occurrence policy, which we now carry again, although the premium is now up to $189,000. We have been gouged once again.

But also, we have been left with an open period. We have no coverage for those claims that arose during that claims-made policy and might come up at a later date, now or 6 years into the future, depending on the statute of limitations. In their generosity, Hartford offered us what is known as a "tail cover." We could buy additional coverage for that period for 1 year at the rate, I think, of about $23,000. For 3 years, we could have had it at about $52,000. We didn't even get into subsequent periods. We frankly just had to make a decision as a community—we just could not continue to pour this kind of money into an insurance company. Had we done it, we would have been paying probably $200,000 for 1 year of insurance.

And for your further information, as it is not stated in the prepared testimony, because I just looked at the data over the weekend—I looked at the claims that were made during that one-year period of the claims-made policy. I went through all my files; all the claims that come in are sent to me first before they are sent to the insurance company, and I never looked at them all together. In fact, there were 35 claims made. Of those 35, 30 of them were for a definite amount of money, so 5 of them were for unknown amounts. Frankly, those 5, I am familiar with the circumstances, and they are largely meritless. But of those other 30 claims, 25 of those are pot-hole cases where the amounts claimed are from $100 to maybe $1,000.

The total of all the claims that are known—if the insurance company simply paid each claimant full for that year—was $8,700, for which we paid $125,000 in insurance, and we have no coverage if something else should come in. It is an amazing situation. In fact, that $8,000 is a good example of what our prior history was, so if insurance is based on our prior history, there is no reason for our premiums to go from $32,000 to the $189,000 that it is today. It is, frankly, ludicrous.

Thank you, Mr. Chairman.

[Statement of Mr. Moody follows:]

STATEMENT

OF

GERALD MOODY

TOWN COUNSEL

TOWN OF MILFORD, COMMONWEALTH OF MASSACHUSETTS

before the

SENATE ANTITRUST, MONOPOLY AND

BUSINESS RIGHTS SUBCOMMITTEE

June 14, 1988

Good morning. Thank you Mr. Chairman and members of the subcommittee. I appreciate having the opportunity to testify this morning.

My name is Gerald Moody. I am employed by the Town of Milford as the Town Counsel. Milford is a named plaintiff in the lawsuit filed by Attorney General Shannon which is the subject of the hearing today.

Milford is a town of 29,000 which was founded in 1780. Up until ten years ago Milford was a primarily a manufacturing town. Today, high tech industries have moved in and we have become more and more a bedroom community for both Worcester and Boston. We provide a wide number of services to our citizens for which we purchase commercial general liability insurance including: schools, parks, and highway maintenance. As with most municipalities in Massachusetts, we were hard hit during the municipal liability crisis in the mid-80's.

We are a named plaintiff in this lawsuit because of our experience during the liability insurance crisis. At this point, I would like to explain our experience with municipal Commercial General Liability (CGL) insurance as it relates to the conspiracy charged in the complaint.

Municipalities, such as the Town of Milford, purchase CGL insurance to protect ourselves from the uncertainty of claims by third parties alleging injuries resulting from some aspect of the town's operations.

In August of 1984 the Town of Milford secured an insurance package which included, among other types of coverages, CGL cover. The CGL policy was written by the Hartford Accident and Indemnity Company. A three year policy was issued with an inception date of August 10, 1984 and a closing date of August 10, 1987.

The coverage trigger for Milford's 1984-1987 CGL policy was an occurrence trigger. That means that any injuries which occurred during the three year policy period would be covered by that policy, regardless of when the claim was actually reported.

The Milford CGL policy was written on ISO's 1973 copyrighted CGL form as amended and adopted by the Hartford. ISO is the acronym for the Insurance Services Offices which is an industry trade association which develops forms for insurance.

The annual premium for the first year of the CGL policy was $32,600.

Sometime during the summer of 1986, we were informed by our insurance broker that the Hartford would be cancelling the CGL policy for the final year of the three year policy period, 1986-1987.

We were then told that our insurance broker was unable to find a municipal CGL occurrence policy from any other admitted companies for the 1986-1987 policy period. The only municipal CGL policies available to Milford were written by non-regulated surplus lines companies. Surplus lines companies in

Massachusetts are not required to submit rates or forms to the Insurance Commissioner for approval. The only CGL policy available to us was with a surplus lines company called the Nutmeg Insurance Company. Ironically, the Nutmeg Insurance Company is the wholly-owned surplus lines subsidiary of the Hartford. The policy offered by the Nutmeg had a claims-made trigger with a retroactive date and an absolute exclusion for all pollution liability. With a claims-made trigger with a retroactive date, the policy only covers acts which occurred during the policy period and acts for which claims were submitted during the policy period. In other words, the policy offered to us by the Nutmeg provided us with much less coverage than the occurrence policy we had had with the Hartford.

During the 1986 renewal season, occurrence based coverage for municipal CGL policies which we had had with the Hartford became virtually unavailable in the Commonwealth of Massachusetts. This was due in considerable part to a hardening of the municipal liability market. In Massachusetts, the Insurance Commissioner had not yet approved the 1986 ISO claims-made CGL form. As a result, only unregulated surplus lines companies, such as the Nutmeg, had legal authority to write CGL policies with a claims made trigger in Massachusetts.

The Town of Milford purchased the 1986-1987 CGL policy from the Nutmeg Insurance Company for approximately $125,000. That was almost four times the amount we had been paying for the broader occurrence policy with some pollution coverage. The policy we bought was written on the 1986 ISO CGL form, which was not approved in Massachusetts, as adopted by the Hartford. For a town such as Milford, paying this substantial increase in premiums was very difficult. Although we did not have to eliminate any services, we were forced to cut corners in other ways. Most importantly, we have not been able to hire needed additional police officers due to a shortage of funds.

During the 1987 renewal season, as a result of a softening in the liability market, municipal CGL insurance with an occurrence trigger was again available in the Commonwealth of Massachusetts. The Town of Milford successfully negotiated, through its insurance broker, for a CGL policy, with an occurrence trigger for the policy period 1987-1988. We no longer had to buy insurance in the surplus lines market. And, ironically once again, this policy was written by Hartford.

Due to switching from a claims-made policy with a retroactive date to an occurrence policy, Milford has been left with a gap in coverage. Milford was insured under a claims-made policy for 1986-1987. Therefore, once that policy period expired, any injury which occurred during 1986-1987 but was not reported, will not be covered by the claims made policy issued by the Nutmeg. Nonetheless, the Town of Milford remains legally liable for all claims arising during that period within the applicable statutes of limitation. Milford is not covered for 1986-1987 under the new Hartford policy, since the Hartford policy was issued August 10, 1987 and only covers claims after that date.

The only way, therefore, for Milford to protect itself for injuries which occurred, but were not reported, during 1986-1987 was to purchase from its current insurer something known as "tail cover." The tail cover was specifically developed for use with the claims-made form where, as with Milford, the consumer switches companies. The tail cover was offered to Milford in the form of either a one year or three year option. In the one year example, the Hartford would agree to cover any claims which occurred during 1986-1987, and were reported during 1987-1988. With the three year option, the Hartford would cover claims reported up through 1990.

The price quoted by the Hartford for the one year tail cover option was $26,120. The price quoted for the three year option was $52,239.

After extensive discussions with our broker and a review of the town's finances, we decided not to purchase the tail cover for the 1986-1987 policy period where we had the claims made policy. As a result, the Town of Milford has no insurance coverage for any future claims submitted for injuries which occurred during the 1986-1987 policy period.

As you can see, the irony in all of this is that we always purchased our CGL insurance from a Hartford company. But the only way we could get fully covered for the gap we had while in the claims-made form is to buy the extremely expensive tail cover. Even though we paid $125,000 for only one year of coverage, the Hartford would not extend its coverage back unless we paid for this tail cover. We would have to keep purchasing the tail cover until the applicable statutes of limitation expired.

You can also see why there is little incentive to switch companies under the claims made form because of the exorbitant pricing of the tail cover.

In conclusion, as a result of the above described events, the Town of Milford has suffered the following negative effects: 1) we are without liability coverage for any future claims which were incurred during the 1986-1987 policy period; 2) our premiums almost quadrupled when we were forced to buy insurance from the Nutmeg Insurance Company in the surplus lines market; 3) as a result of the tremendous increase in premiums, we have had to make very difficult budget allocation decisions.

Thank you very much for your time. I'll be happy to answer any questions.

Senator **Metzenbaum**. Thank you very much, Mr. Moody. Thanks to each of you for being here today.

We have not heard the last of this subject. We will carry on until such time as we enact the legislation.

The subcommittee is adjourned.

[Whereupon, at 12:53 p.m., the subcommittee was adjourned.]

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